The Canadian Chartered Accountant

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THE TAX REVIEW

JANUARY 1955

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SWEETNESS and LIGHT

By Jay Vee

How Long Is a Year?

As any school child will tell you, the Year of Our Lord 1955, upon which we are just entering, will be certain to have 365 days, and the year following will be equally certain to have 366. Each will contain four seasons, and in general winter will be cold, summer hot, spring and autumn in between.

But this was not always such an elementary affair. For centuries the Romans gave every year a straight 365 days, not taking into account that the solar cycle is a fraction of a day over the 365. By the time of Julius Caesar things were badly out of kilter; there was a difference of 3 months between the civil and the astronomical equinox. The middle of summer according to the calendar was the middle of spring according to the sun, and the middle of spring in turn was chilled by those cold northern blasts which the world identified with the middle of winter.

To a well-organized mind like Julius Caesar's this confusion was not to be tolerated, and he decided to take action. Beginning January 1, 45 B.C. he instituted the Julian calendar which was based on the premise that the solar year is 365¼ days. The first three years, 45, 46, and 47 B.C., were to be common years of 365 days, the fourth, 48 B.C., was made a bissextile or leap year of 366 days, the pattern was then repeated for the next set of 4 years, and so on indefinitely.

Unfortunately there was a slight inaccuracy in this scheme. The solar year

Sweetness and Light

is not 365¼ days, but rather 365 days, 5 hours, 48 minutes, and 46 seconds. Caesar had supposed the year too long by 11 minutes, 14 seconds. A mere trifle at the time, of course, but every 128 years one full day of the next year is stolen.

Nobody seem to care one way or the other for over 1600 years. It was Pope Gregory XIII who saw that the calendar was falling behind the equinox and heading for the exact opposite error to the one which Julius Caesar had tried to correct. In order to restore the civil year to the solar year once more, he directed that the 10 days October 5 to October 15 be suppressed in 1603. (Just what happened to the children who had birthdays during that period is not reported.) He also inserted an amendment into the Julian leap year clause to reckon the century years as common rather than leap unless they were divisible by 400. Thus 1700, 1800, and 1900 had no February 29, but 2000 will have.

But even this best-laid plan "gang agley" slightly. Pope Gregory's year was 26 seconds over the solar system, and now the suggestion is to make the year 4000 common even though it is divisible by 400. Just in case anyone is still around at that time, that is.

How long then is a year? The western world's answer is not the only one by any means. In some places the basic unit is a half-year of two seasons. Personally we are fascinated by the "vegetation year" found among some peoples in North-east Asia and the East Indian Archipelago. It begins with the planting of seed, ends with the harvest, and takes about 10 months. The other two months are simply passed over as a vacant period and not counted at all. What a chance for ignoring debts, deadlines, and dental appointments!

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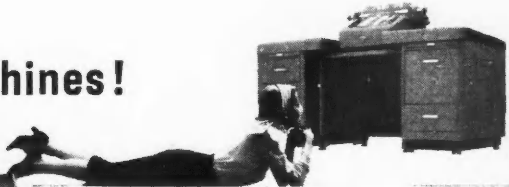

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The Canadian
Chartered Accountant

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COMMENT AND OPINION

LIFO Upheld by Supreme Court of Canada

THE Supreme Court of Canada, by a majority of three Judges to two, has now affirmed the Exchequer Court decision in the *Anaconda Company's* case permitting the use of LIFO in valuing the company's closing inventory. The basis of the majority judgments appears to be that a taxpayer is entitled to employ that method of inventory accounting which the ordinary principles of commercial accounting indicate will reflect his income most accurately. From this conclusion the Chief Justice and Mr. Justice Estey dissented, their view being that an arbitrary assumption, acceptable for ordinary accounting purposes, is not acceptable for taxation purposes if it is contrary to the actual facts. The Chief Justice felt that the assumption upon which LIFO was based had been shown by the evidence to be contrary to the facts, while Mr. Justice Estey seems to have thought that the "lower of cost or market" formula did not apply to inventory valuation for taxation purposes, and that for those purposes stocks must be valued at their actual, i.e. market, value.

It has since been announced that the Crown will carry this dispute to the Judicial Committee of the Privy Council, to which body an appeal still lies in this case: the amount of tax involved is very large. A decision by the Privy Council that LIFO is not an appropriate method of inventory cost determination for taxation purposes will of course be a very happy solution for the Crown. Not only will it result in recovery of the large sum in dispute but it will also resolve the larger question for all time. An unfavourable decision will, however, leave the Crown faced with the decision either to accept it with the best grace it can muster or to amend the Act to rule out or regulate the use of LIFO. To propose such an amendment in the face of the uniform decisions of the Exchequer Court, the Supreme Court of Canada, and the Privy Council might produce a delicate situation for the Government in the House of Commons, and the Senate as well, though no one can suppose that the amendment, if proposed, would not be effected. A change in the Regulations would not be enough, since section 14(2) of the Income Tax Act expressly permits the valuation of inventory at cost, *inter alia,* and if the Privy Council affirms the decision of the Supreme Court of Canada, LIFO will seemingly be recognized as a method of ascertaining the cost of inventory for taxation purposes.

Federal-Provincial Relations

WHAT has always fascinated us most about the accounting profession in Canada is the uniqueness of its organization, with a national body and ten fully autonomous provincial bodies. Canada itself has a somewhat similar struc-

ture, but with one significant difference. Whereas the Canadian Constitution confers exclusive power on the Dominion over certain matters and provides that in case of conflict with a Province the federal authority shall prevail, the national body of the accounting profession has no power whatsoever over the provincial bodies, for whom nonetheless it performs a great many important services. Thus it is the national body, the C.I.C.A., that publishes *The Canadian Chartered Accountant,* carries on a program of accounting and auditing research, conducts the uniform examinations, and studies and makes submissions on taxation, company law, and other matters of national concern.

Today the relationship between the C.I.C.A. and the ten provincial Institutes is a happy one. The C.I.C.A. has its function, the provincial Institutes have theirs, and while it is not true that the twain shall never meet, there has not, in our time at any rate, been any conflict between them. It was not always so. The C.I.C.A. started out in life more than half a century ago as a rival to the then existing provincial Institutes. Like them it established qualifications for admission to membership, authorized the use of the designation "Chartered Accountant", and asserted educational and disciplinary powers. Naturally this led to war with the provincial Institutes, a war fought out in the Legislatures and Cabinets of the Province of Ontario and the Dominion of Canada, the outcome being a negotiated peace which established the present harmonious relationship between provincial Institutes and the C.I.C.A.

Most significant result of all is that the C.I.C.A., though shorn of its powers, is today the acknowledged organ of the accounting profession in Canada, with high prestige and influence in the profession and outside of it, in Canada and abroad.

Reckless Statements by Auditors

UNDER the Criminal Code of Canada an accountant or auditor may lay himself open to criminal prosecution leading to a maximum of ten years imprisonment if he makes, circulates or publishes a prospectus, statement, or account that he knows to be false in a material particular, with the intent of inducing persons to subscribe for stock in a company, advance it money, etc., or if he aids or abets anyone else in the commission of that offence. In England the law goes somewhat further, as one accountant has recently found to his cost. Under Britain's Prevention of Fraud Act of 1939 any person who by the reckless making of any misleading, false or deceptive statements induces or attempts to induce another person to subscribe for stock or advance money to a company, etc. is liable to imprisonment up to seven years.

In the case in question, which was tried by a Judge and jury in the Central Criminal Court in London last June, a furniture manufacturing company issued a prospectus which contained a report by the auditor stating that the stock and work in progress, as valued by the company's officials at the lower of cost or market value, amounted to £641,607, which was in fact a gross overvaluation. It was established in evidence that the stock sheets, showing an original valuation of £495,000, had been plainly altered but that the auditor's only action was to ask the managing director's reason for the alterations; and he accepted the latter's explanation that the reason for the change was that the original values were all wrong. In the auditor's justification it was pointed out that he had first met the company's managing director many years ago when he entered his father's firm of accountants, and that he had been the company's auditor for 28 years and had always readily accepted

the explanations of the managing director, against whom there had never before been any word of suspicion. The managing director, it may be added, pleaded guilty to fraud charges against him, but the auditor insisted on his own innocence.

The jury acquitted the auditor of *knowingly* aiding and abetting the managing director in publishing false statements with intent to deceive, but they found him guilty on one count of recklessness. While, as said above, mere recklessness in making false, deceptive, or misleading statements does not appear to be a *criminal* offence in Canada — though it may well have unfortunate consequences for the defendant in *civil* proceedings — the decision is nonetheless quite illuminating for the Canadian accountant. The following excerpt from the Judge's summing-up to the jury is interesting.

> It is quite impossible . . . . to lay down that an auditor is correct and not being careless if he accepts the explanation of a director to any question he may put to him . . . Quite clearly you must look at all the circumstances of the case, and taking into account all the circumstances, say to yourselves, "Would a reasonably careful auditor and accountant be satisfied with the director's answer or the director's entry in the book, or ought he as a reasonably careful auditor and accountant to have gone further and checked it in some way?" That is really the question. You cannot, of course, lay down strict rules as to what is care and what is not. You must take into account all the circumstances of the case and make up your minds about it. You may of course take it that if an auditor neglects to take the reasonable steps that you think he ought to have taken, then he is being careless; but if he is careless, in all the circumstances, to a high degree so as to be deserving of punishment, then you may take it as being reckless.

Ave atque Vale

WITH sincere regret we must tell our readers that Melville Pierce, our managing editor since February 1948, left us at the end of December. For more than six years Mr. Pierce devoted himself to *The Canadian Chartered Accountant* and particularly to its Tax Review department, and the magazine has come a long way under his guidance.

The format has improved; the size has increased; many monthly features have been added. Accounting is never static, and Mr. Pierce's choice of articles and pungent editorials have helped to keep our readers informed on matters pertaining to the changing demands of practice. In addition to his editorial duties, he acted as secretary of the C.I.C.A.'s Taxation and Companies Act Committees where his profound knowledge of taxation and company law contributed substantially to the effectiveness of their activities.

However, we are fortunate in not losing Mr. Pierce's talents entirely. He will continue as a contributing editor and be responsible for the monthly Tax Review. Meanwhile, we feel sure that our readers from coast to coast will join us in wishing him every success in the future.

Renny Englebert, who has been the Institute's assistant secretary-administration for the past two years, has now been appointed assistant secretary-publications and will be the new editor of the magazine. To this post he brings a keen awareness of the potential role which *The Canadian Chartered Accountant* can play as a representative of the profession in the business world.

Jean Vale (alias Jay Vee), our capable assistant editor, will continue in that position and, in addition, will assist Mr. Englebert in his other responsibilities.

Internal Reports to Management

By Malcolm S. Sutherland, C.A.

An internal report, properly presented, can have a powerful effect on managerial policy

TO controllers and accountants the internal report presents three challenges:

(1) To conceive and design the most effective report.

(2) To gather and process the proper basic information.

(3) To establish the acceptance and usefulness of the reports.

Those of us in public accounting will agree that great strides have been made of recent years in the design of reports and in the gathering and processing of information. Perhaps, however, we have been too concerned with this aspect of our work and not enough on establishing their usefulness.

Motivation

Good business demands good reports, but not all executives have the same attitude towards reports. Some desire a great variety of details, some desire as few as possible. Some will only deal with situations as they arise from day to day, some are vitally interested in planning and in performance figures as yardsticks.

The attitude towards internal reports is intimately bound up with the characteristics and size of the business enterprise, as well as the overall sense of responsibility of its management. Management as a group shares with the controller the task of developing good reports. The controller and the accounting group alone cannot do a satisfactory job.

The appetite of executives for internal reports will be sharpened by situations that indicate control is required, and interest may be developed by informal talks between executives of different organizations, the company's auditors, technical, business and educational associations and publications, and management consultants.

This list indicates the strategic place the controller and the accounting fraternity occupy in the development of informative reports. Great credit is due to this group for the ingenuity they have shown over the years in designing reports and establishing controls.

Basic Plan

In appraising a plan for providing management with essential reports, we should be careful to distinguish cost information from information as to sales,

A paper read to the 1954 annual conference of the C.I.C.A., August 25

purchases, expenses, wages, and salaries. While certain specialized businesses require reports to show process costs at the various stages of manufacture, reports relating to the functions and centres of responsibility provide information more suitable to the general administration of the enterprise. Thus cost determination, which involves constant studies of processes, equipment, prices, etc., is dealt with separately and allowed to realize its wider scope and its own specialized functions.

Controllership

The basic principle underlying internal reports can be best seen against a background of controllership. What is controllership? I quote in part:

> The practice of controllership is the exercise by a trained mind of the techniques of control. In our own special sense, the word "control" always includes three component processes:
> (1) Adoption of a plan.
> (2) Reporting of actual performance as compared with the plan.
> (3) Making decisions and taking action.[1]

Accountants are more than familiar with the techniques of budgets, budgeting, and the budgeting control process. Many of us have encountered a reluctance on the part of management to accept detailed planning — the key to good budgetary control. It is the role of the controller to promote and encourage acceptance of the trained approach to business problems.

A good basic plan for internal reports, then, is based on a classification of information according to functions and responsibilities and a comparison of actual performance with budgets or yardsticks of some type.

[1] From an address given in Hamilton on "Controllership and Accounting: A Contrast", by J. L. Peirce, Vice-President, A. B. Dick & Co., Chicago, published in *The Canadian Chartered Accountant*, July 1953.

Principles of Internal Reports

The general principles followed in the designing of reports are as follows:

1. *Responsibility centre.* — The most effective control seems to be obtained when the report deals specifically with the function for which an individual executive, manager, or foreman is responsible. Closeness of report to the work centre promotes better supervision.

2. *Controllable costs.* — Elimination of overhead and uncontrollable items reduces friction on departmental statements.

3. *Comparability.* — The report should compare actual results with the budgetary prognosis and show the differences for the period, as well as an accumulation of them to indicate the trend to date.

4. *Flexibility.* — The information should be capable of expansion or contraction. This allows a brief report to be issued first, followed by more detail if required.

5. *Brevity.* — The rule of management by exception should be followed. Indicating essential information only helps to get reports out earlier.

6. *Promptness.* — Internal reports can set pace. Effectiveness of reports decreases in ratio to the time lag.

7. *Accuracy.* — General accuracy only is required. Minute accuracy is beyond needs of user. Dollar accounting cuts clerical time.

8. *Frequency.* — Reports should be daily, weekly or monthly according to the operation and control desired. Four-week periods in place of months have administrative advantages.

9. *Style and Presentation.* — Best presentation possible commands respect.

10. *Explanations.* — Sufficient departmental statistics should be included to give a proper picture. Explanations for out-of-line items can very often be put on statements while processing.

Presentation

There is little doubt that the profit and loss statement is our most important internal report. Many other reports stem from the profit and loss presentation. It sets the tone for other reports and also indicates the general attitude within the organization toward the record-keeping function.

Five different presentations applicable to a manufacturing company are indicated below together with their general purpose:

1. Basic

Sales	1,000,000
Total costs	700,000
Profit from operations	300,000
Depreciation	75,000
Interest	25,000
	200,000
Tax	100,000
Net profit	100,000

This is the conventional form which, with variations, usually appears in statements to shareholders.

2. Line Classification

Sales	1,000,000
Materials	350,000
Labour	250,000
Expenses	100,000
Depreciation	75,000
Interest	25,000
Taxes	100,000
Profit	100,000
	1,000,000

This form is the basis of those pie charts which have been adorning so many published annual reports. It illustrates the relative importance of functions within the business.

3. Product Classification

Product	*Sales*	*Operating Profit*	%
A	500,000	200,000	40
B	400,000	50,000	12
C	100,000	50,000	50
	1,000,000	300,000	30

With this presentation management can determine the profit by product lines. Fluctuations in profit because of changes in sales mix will also be indicated.

4. Marginal Income by Product

Product	*Sales*	*Direct Costs*	*Marginal Income*	*Ratio*	*Standing Charges*	*Operating Profit*
A	500,000	275,000	225,000	45	25,000	200,000
B	400,000	285,000	115,000	29	65,000	50,000
C	100,000	40,000	60,000	60	10,000	50,000
	1,000,000	600,000	400,000	40	100,000	300,000

Memo:

Material	350,000
Labour	200,000
Power	10,000
Supplies	30,000
Salaries	5,000
Expense	5,000
	600,000

Memo:

Labour	50,000
Power	5,000
Supplies	5,000
Salaries	30,000
Expense	10,000
	100,000

Mr Malcolm S. Sutherland, C.A. is the comptroller and secretary-treasurer of Burlington Steel Co. Ltd., Hamilton. He has been a member of the Ontario Institute since 1937. In 1951-52 he was chairman of the Hamilton and District C.A. Association. In 1952-53 he was president of the Hamilton Control, Controllers Institute of America. At present he is vice-president of the Hamilton Branch of the Canadian Red Cross Society.

This approach, which is also known as "Direct Costs" provides the basic information on which the "Break-Even Technique" is founded. It is, as well, essential to flexible budgeting.

It provides management with a wealth of essential information, not available under the total cost concept referred to in the third illustration above. The marginal income ratio indicates a different rate of return by product and one that is not subject to changes in volume which existing facilities of the business can satisfy. The impact of overhead application in the product cost structure per unit is negligible compared with the development under total cost.

On the other hand marginal income emphasizes the standing charges which, with depreciation, represent the costs of maintaining the facilities of the enterprise in its present markets. Some cost groups in Canada, as well as in the United States and Great Britain, hold that the marginal income presentation comes close to the actual thinking of the average businessman and to the marginal concept of economic income.

5. Value Added in Manufacture

Sales value of production	**1,000,000**
Materials	**350,000**
Supplies, power, fuel, etc.	**50,000**
Value added in manufacture	**600,000**
Wages	**250,000**
Salaries	**35,000**
General expenses	**15,000**
Operating profit	**300,000**

Notes:

Man hours	**125,000**
Value added in manufacture per man hour	**$4.80**
Comparison	
1953	**4.52**
1952	**4.15**
1951	**4.02**

The above presentation may seem unusual but it has some statistical background. I understand certain textile groups use it under the term of "Conversion Costs". However, since 1917 the Bureau of Statistics has been publishing a comparable series of statistics on manufactures which it calls Net Value of Products (or Production), which is "computed by subtracting the cost of fuel and electricity and the cost of materials from the gross value of products". It also relates the annual salaries and wages paid to this series. The current *1954 Canada Year Book* sets this out on p. 620. Corresponding information has been compiled in the United States.

The significance of this approach lies in the concept that "the value added in manufacture" represents a "fund", from which wages, salaries, and the general expenses of the business are paid.

With the application of statistical or cost data certain important information becomes available. In the example above, the value added in manufacture per man hour can be tabulated in comparative form for a number of years to indicate the productivity of the working force in terms of current dollars and related to the average hourly earnings paid.

In the same way, comparisons can be made using salaries paid, maintenance costs, or expenditures on capital, which throws a new light on the behaviour of

these as well as on innumerable other classes of expenditures.

It is of more than casual interest that by applying the appropriate price indices it seems possible to overcome the effect of changes in price levels and to express this information in terms of constant dollars, a requisite to the disclosure of basic trends.

Areas for Improvement

I would like to mention a few areas where reporting can stand improvement.

1. *Statistical presentation.* — We can use statistical procedures more than we have. One that comes to mind is that of indicating trends through the use of annual moving averages by months. From here it is only a short step to graphs which convey information dramatically and quickly.
2. *Business statistics.* — Use of business statistics, particularly in market research, is becoming more general. The desire for more information from the Bureau of Statistics and trade associations by the larger companies is growing in contrast to a very practical view held by the smaller companies.
3. *Cost of one hour's work.* — Better information is desirable in the field of labour relations. To illustrate, the U.S. Steel Company portrays "the cost of one hour's work" including all fringe benefits. Much of the discussion in wage negotiations centres around workers' productivity and related problems. Improvement in obtaining facts in this area would be more than helpful.
4. *Productivity.* — "We need a good, simple, understandable definition of productivity."[2] We understand "rates of production" and output, but these have no real meaning until the goods are brought to the market place. Some work has been started on this complex problem in Great Britain, and considerable research has been undertaken in the United States.

There is some real evidence that reference to "Value added in manufacture", as discussed earlier in this paper, can be of use in indicating "productivity", a subject our reports will soon have to deal with.

The marshalling and presentation of information through proper reports can have a powerful effect. Many of us have the information buried in our records. Why not bring it to light?

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[2] From an address, "Productivity: An Important Function in Management", given at the 1953 annual meeting of Controllers Institute of America, by John W. Roberts, Vice-President, Albert Ramond & Associates, Inc., published in *The Controller*, March 1954.

Canada at Work

By J. Gerald Godsoe, C.B.E.
Vice-President,
The Canadian Chamber of Commerce

Canada is standing on the threshold of a new era, says this enthusiastic spokesman

MY story is one of incurable and unashamed optimism. There are many things happening in Canada today, and many more are going to happen. We who live there believe we are living in great times!

This is good news for all of us. For the economies of Canada and the United States are so closely interwoven, and our destinies are so wrapped together, that what is good news for Canadians is also good news for Americans.

A Half-Century of Accelerated Development

As a backdrop to assess in better perspective exactly what is occurring in my country today, let us look at Canada in the light of a few simple facts, with a brief reference to a transition that has been taking place there since the turn of the century but which has become particularly accelerated during the past fifteen years. We are still a young country. We are but eighty-seven years old, with all our growth occurring in the past fifty years. We are a large country, exceeded in size only by two other countries, one of which is our sprawling neighbour immediately to the north. We are about the same size as the continent of Europe, and somewhat larger than the United States with Alaska. We have but fifteen million people. Our population is less than that of New York State. We enjoy a position as a free nation and are at the same time a member of the British Commonwealth. We pay neither taxes nor tribute to any government other than our own — although. I hasten to add, we pay plenty to our own. We formulate our own policies, negotiate our own treaties, and we accredit our own diplomats. In World War II, contrary, I believe, to public conception in the United States, we were as free to declare war, or to abstain from it, as was the United States. We declared war subject to only one compulsion, that of our own conscience. In the same way, (and I do not believe this is generally known in the United States), following Pearl Harbor, we did not await the lead of Britain, nor indeed that of the United States. We actually declared war on Japan before either country — and before any other country. We are very proud of that.

During the first half-century following her birth, Canada remained predom-

An address to the 81st annual assembly, Chautauqua Institute, July 1954

inantly an agricultural country. Even as late as the turn of this century, one half of her working population was on farms. But she had long been turning towards industrialization and the first great movement towards the industrialization which exists today came with World War I. At that time, prompted by military demands, steps were taken to promote the development of basic and secondary industries, particularly in the non-ferrous metals and steel industries. A further intensive and more general expansion occurred from 1926 to 1929 — but it has been since 1939 that the most extensive development has occurred.

Under the pressure of World War II, Canada expanded tremendously her industrial capacity and built up a large skilled labour force — in addition to having a million citizens under arms. The great magnitude of and pride in our war effort brought not only new confidence to businessmen but to the whole Canadian people. An attitude of caution, fostered by previously indicated weak spots in our economy, began to give way to a vibrant faith in the solid future of the country.

The Threshold of Greatness

Fifteen years is a short time for history to work out a peaceful revolution in a nation, but that it what has occurred in the economy of our country since 1939, with the result that today there seems no doubt about it to us in Canada, we are on the threshold of one of those tremendous surges of development which, through the years, have brought one nation after another to a position of greatness.

As we have, during this period, been pushing our frontiers further and further back, we have uncovered a constant succession of new strategic treasures — undreamed of a few years ago, and the development of which will mean more and more to the growth and prosperity of our country, to trade relations between our two countries, and to the cause of peace in the world.

Travel today across the country's breadth of four thousand miles and you will see everywhere a dynamic growth. You can listen at any moment and hear our country growing. As I am speaking to you, almost any Canadian, in any settlement, can hear the magic sound of expansion, great and small. The superstructure of a strong and vital nation is going up. In Edmonton, for example, in far-away Northern Alberta, at this moment dozens of planes are getting ready to set off for further north, and before the day is out 300 planes will have roared into its airport.

Even the normally quiet city of Toronto, from whence I come, and of which it used to be told — and quite recently — that there "every day was a Sunday," is said to have become the biggest and most boisterous boom town in Canada today.

The country is offering opportunities to capital, to industry, and to individuals unequalled since the opening of the great West. We are entering a new era in Canada, and no shadow from the international storm clouds can obscure the fact.

Now what has happened since 1939?

Rapidity of Growth

Canada today, by virtually any statistical standard, is growing faster than any other nation.

We have been transformed from a country with an emphasis on agriculture to one with an emphasis on industry. The transition has been steady and decisive.

It should be pointed out, however, that agriculture has not declined while industry has been reaching a more dominant position. Today there are more

farms, more farmers, and more acres under cultivation than before the war.

We have become the world's third trading nation, second only to the United States and Britain, while still ranking behind dozens of countries in population. The dollar value of our trade last year was over five times that of 1939. As this development has occurred, it has been accompanied by a sharp upswing of Canadian buying in the United States — across our border today moves the greatest flow of trade in the world.

Since 1939 we have quadrupled our national production, climbing from a lowly par with Norway and Sweden to the position where our output is now more than double that of these Scandinavian countries and rivals that of France.

Our national income has increased four times and our standard of living has doubled. We are the only major country with a living standard comparable to that of the United States.

Our population has increased 33% since 1939, and in terms of population we are now one of the fastest growing countries on the globe.

Investment in Canada

The United States has been investing in Canada during the past several years up to a billion dollars a year, giving her an investment today of $8.5 billion in our country — her heaviest stake in any outside country.

Canada today is outdistancing any other country in the record amount of earnings being ploughed back into capital expansion and into new development. In 1953, about 23% of all our earnings were treated in this manner. Further, of the total investment in our development last year, about nine-tenths was Canadian money, in contrast to the situation not so many years before, when fully one-half of the investment came

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from outside our borders. Added to this is the fact that, since the end of the war, if we take into account what we have given, loaned and invested abroad, it will be found that we could have provided enough capital out of our own savings to finance the whole of our own development program.

And lastly, and perhaps as great a symbol as anything of our growing strength has been the robustness of our dollar. The Canadian dollar after being at a discount in terms of the United States dollar for some long period recovered its self-respect a few years ago, attained par with the United States dollar, and has remained in a healthy state since. Indeed, the Canadian dollar today is quoted at a premium in terms of the United States dollar.

Financial Aid to Others

And while all this has been going on we have paid our own way both during and since the war and have accepted gifts from no country. In the same period we have given over $7 billion in war and postwar gifts and credits to our allies. On a per capita basis this compares favorably, and on an income basis more than favorably, with the generous record of the United States. Further, this year 45 cents of each tax dollar we collect will go to defence. In other words, our 1954 defence bill will be twice our overall government spending in 1939. Many thousands of young Canadians fought in Korea, and we have troops there today.

In Europe we have an army brigade group under the flag of NATO and an air-division of 300 Canadian-built front-line jet fighters. And, of course, we are joined with the United States in the development of defence installations of various types for the protection of this continent.

Two Contributing Factors

The next question that arises is "What has brought about this sudden and tremendous development in such a short space of time?"

The answer to this lies in the fact that we have been engaged in two vast economic growths. First of all, we have lately had discoveries of some of the most important resources to which a modern-day country can lay claim, of a nature and a magnitude previously unknown. I am referring principally to our new oil and gas discoveries, our new iron ore reservoirs, our new finds of uranium, and our discoveries of other strategic metals of prime importance in the age in which we live. Of even greater significance, we will be pushing forward our quest for new treasures as never before, and ever greater developments will be taking place in the future.

But the other development has been just as significant — a tremendous wide-spreading growth in our heavy and ancillary industries. The two kinds of economic growth are at work together.

"The pace they are working at," as *The Economist* puts it, "would be remarkable in either alone; in the two combined, it is as exciting and impressive as any achievement of industrial civilization."

Oil and Gas

Perhaps the greatest single factor in the present day miracle that is occurring in Canada has been our discoveries of oil and its fellow-traveller gas, and the promise of many more such discoveries to come. Eight years ago, Canada imported nearly ninety percent of her crude oil; she had reserves of about 70 million barrels; and, after a long and discouraging history of successive dry holes, only a few million dollars were being spent in exploration and development work — and this only by the hardiest of companies.

The estimated reserves have jumped to close to three billion barrels. Over $350 million will be put this year alone into exploration and development work. Close to $1.5 billion has been spent by the oil industry during the seven-year period since the discovery at Leduc in 1947. A new strike or discovery of oil or gas was made on an average of every third day last year. Discoveries have been made in each of the four western provinces and at widely separate parts of the country. Over 2,600 wells are expected to be drilled in 1954. Western Canada today is the second most active spot in the world in geophysical work. — This is today's story.

The most striking feature, however, is that the greatest growth still lies ahead. We expect to be self-sufficient in oil during the course of the next few years and to be exporting it soon to the United States Pacific Northwest.

One more word before I leave the future, although here I am really getting into the field of conjecture. We have northeast of Edmonton, in a vast reservoir, what are reliably reputed to be petroleum reserves, greater — and perhaps extensively greater — than the entire known world reserves of today. These are locked in bituminous sands, and the chief obstacle in the way of their utilization is the economical separation of the oil from the sand. Scientists have been working on this for some years, but of late have become increasingly active. I believe there are many problems ahead

before any success will be achieved, but I do feel, with full confidence, that with time a way will be found to extract this oil economically. The whole history of the development of our two countries is one of overcoming obstacles and of surmounting difficulties.

The story of gas is similar to that of oil, with new discoveries occurring regularly, and proven reserves mounting steadily. Plans are now underway to start a gas pipe line on its long journey eastward to the markets of Ontario and Quebec to become the world's largest pipe line. An oil pipe line system of over 4,000 miles already spans the country to the west coast and to Ontario in the east.

Iron and the Wonder Metal

So far as iron ore is concerned, our biggest news has been the new development now under way in Quebec and Labrador, on which more than $250 million is being spent. The ore is excellent; once development starts it is easily obtained; and while all sorts of estimates have been made of the reserves by competent engineers, it can be stated conservatively that it is one of the world's richest bodies, extending over an area forty times greater than that of the Mesabi Range. The first shipment of ore left the shores of the St. Lawrence to start feeding the hungry furnaces of steel mills in Canada and the United States in July, and it is expected a minimum of 10 million tons of ore a year will be shipped to the United States once the project gets under way with the figures being upped to double this production — depending on future developments.

This project has so caught the imagination of our people that even in Canada it is overlooked that more than a few other iron ore developments of importance are also under way at widely separate points, which indicate clearly that we on this continent need have no fear about the future insofar as this indispensable commodity is concerned.

Perhaps the discoveries of late, however, which have caught most the imagination — and indeed, the speculative fancy of the Canadian public — have been uranium. Already a principal supplier of the United States and other free countries, we made an entirely new discovery recently in Saskatchewan, which is the largest on the continent, and may prove to be the largest on the globe as it goes into production.

I am not going to refer to all our metals, but I might say that uranium, cobalt, nickel, titanium, the magical new featherweight metal, which will probably house coming engines of atomic power, and tantalum and columbium, rare metals in high demand, for use in jet engine and other high temperature alloy work, we find we have in such supply that it has been said that they could decide the first atomic war, should that war, God forbid, ever come.

Hydro Power

The availability of low cost hydroelectric power, and its increasing development during the past few years, has been another factor that has meant a great deal in the growth and in the industrialization of our country. No single feature of our industrial life has meant more than hydro-electric power. We boast nearly one horse power hydro capacity per person — more than that of any other nation — and even so we have developed today less than one-fifth of our potential — and I am excluding from this the horse power that will result from the climax of the forty-year fight for the development of the St. Lawrence Seaway. It is because of low-cost hydro that we have been able to build up, for example, a gigantic aluminum industry in Quebec, and because of it also, to em-

bark upon an even greater one in British Columbia, at Kitimat, where development work for what will be the world's largest plant is now under way. The whole job when completed will cost well over half a billion dollars, and a few years hence will have changed Kitimat's thick and wild interior into a booming community with a population of from 30,000 to 50,000. The power is expected to cost one-third as much as power generated to the south in the United States.

And within the past few months, just as we were beginning to get used to the vastness of Kitimat, we were advised by the Federal Government that they had given permission to a large Canadian mining company to make a water power survey in the Yukon, which might very well lead to a development that could dwarf Kitimat.

The story of Kitimat, but in varying and smaller degrees, is being repeated today many times throughout the country, where, because of the availability of millions of unharnessed horse power of cheap hydro, and other resources, what are now wild and unpopulated thicknesses will be transformed into modern and thriving communities.

Industrial Development

The industrial side of our economic development is very closely allied with the resources side. It is the most natural thing in the world for us to have developed into an industrial country. We have the raw materials, we have the cheap water power, we have the coal and petroleum, and we have the technical skills. At present with the exception of a reducing number of specialized products, we are today making about everything that is made elsewhere in the world.

Manufacturing, once little more than a sideline, today provides our source of livelihood, with our industrial capacity having doubled during the past ten years. Today thirty-three cents of each dollar of our national income is derived from industry, as compared to one-fifth but a short time ago. Thirty-seven cents of each dollar is the record in the United States, so you can see that we are pretty well paralleling the manufacturing prominence of that country. In ten years our industrial capacity has more than doubled, with the result that today there are more Canadians employed in manufacturing than in agriculture, mining, fishing, finance, and our public utilities combined. New plants are springing up daily across the country, and while naturally enough some of them will experience growing pains, and others mortality, there is no turning back and Canada now ranks as an industrial nation.

In the wake of our new found gas and oil, in addition to primary industries we are commencing to see a continuing development of heavy and ancillary industries on a large scale. As an example of this, our petrochemical industry, still in its infancy, during the past few years has developed into a $275 million investment and I foresee it becoming one of our truly great industries. In Alberta today plants are turning natural gas into tons of sulphur, so essential to many of our basic industries, while others are producing chemicals to fertilize the rich lands of prairie farmers. In this Province also, there will soon be in full operation a great petrochemical horn of plenty — three plants, built at an estimated cost of $85 million, spewing forth a large range of chemicals, many of which will be made in Canada for the first time. Prairie natural gas and British Columbia wood pulp are being teamed up to produce cellulose acetate and acetate staple fibres and filament yarns, as well as other organic chemicals. In Manitoba, ammonia from natural gas is

being used in a new leaching process to recover nickel, copper, and cobalt mined in a newly discovered rich area. And when the western natural gas is piped east, there will be further industrial developments of importance.

Industries of the New Age

With the strategic metals on our doorstep, we are taking steps to develop new and specialized lines identified with the new age in which we live — for example, jet aircraft, electronics, and also the peacetime use of atomic energy, on which we have already made a good start. As an example of what is going on, but a few months ago we were alerted to the fact that on the drawing boards of one of our companies was a plane that might very well make the flying saucer a reality — a radically designed circular-shaped jet of supersonic speed. Even more recently, within the past two weeks, word has been passed on that this same firm was developing a new top-secret jet engine, reliably claimed to be the most advanced yet developed.

So far as atomic energy is concerned, with world-scarce uranium at our command, we are preparing ourselves to ensure that we will be ready for the new era in which nuclear energy will play such a far-reaching role in our lives, with its almost infinite application to mankind's needs and wants.

We already have developed the use of isotopes for use in industry, medicine, forestry, and agriculture; we are a leading producer of the so-called cobalt bomb which is in use in many hospitals in Canada, the United States and other countries; we have announced a program for what may be the world's most powerful nuclear reactor and we are embarking upon plans for economically feasible atomic-generated electric power.

The Industrial Future

Looking to the future of our manufacturing we can, I believe, consider ourselves to be in a favoured position. with an unquestioned future, particularly once trade sanity returns to the world. As a young country just getting established in an industrial way, we find ourselves unhampered by the past, but we have the past to draw on. We can profit from the experience of United States and British industrialization. We can start new projects without recourse to established or obsolete techniques or to old plants which hinder efficiency and help increase costs. We have the advantage of being able to try out new ideas, to avail ourselves of the latest scientific and technological developments, and as a result to find more efficient ways of doing things. For example, in aircraft we have been largely able to avoid the experimental shop area and enter the large scale scene after the industry found it could adopt automobile assembly techniques.

However, it is no good to have the most modern of plants if we do not have at the same time the productive efficiency to enable us to compete not only in our own markets but, what is very necessary, to compete sucessfully in outside markets as well. Our productive efficiency has been mounting steadily. But we realize that to compete we must keep our unit costs down.

The American market is sixteen or seventeen times as large as ours, and such a home market brings into operation right away mass production with its consequent lower costs. To help overcome this handicap we must keep abreast of research and the most modern developments, specialize in certain industries, practise the utmost efficiency, and strive for a higher productive capacity per hour.

So far as labour is concerned, employee-employer relations on the whole are good. Since 1940 the numbers in the trade union movement in Canada have more than trebled. Generally it may be said that anyone, whether identified with management or labour, who wants to play the game will find a greater era of response today in Canada than at any time in her history.

Canada's External Trade

Now for a word on Canada's external trade. Any discussion of "Canada at Work" is incomplete unless reference is made to this, when it is borne in mind how greatly dependent our economy is upon it, to the extent that over twenty-five cents of every dollar we earn comes from exports.

Since 1939 we have increased our consumption of United States goods over 500 per cent to a record $3.2 billion last year, or twenty-six per cent of all her exports. Today, we make more purchases of her products than any other nation, and more than Great Britain, France, Germany, and Italy combined. We are her best customer. In turn, our sales to her have also increased greatly, although last year they were still $750 million short of what she sold us. Based on last year's figures, on a per capita basis each Canadian purchased $214 worth of United States products compared to approximately $15 spent by each United States citizen on Canadian products. Canada's continued ability to buy in large scale from the United States depends on our ability to sell to that country and to other countries that can trade with her.

We cannot produce solely for domestic consumption because of our few numbers. Consequently, we sell abroad a substantial portion of our entire output. This external trade is essential if we are to continue to have our industries thriving and our resources developing. In addition, there are many things that will not grow in our climate, and others which we cannot make economically, and in obtaining these we must offer in return our products to outside markets. External trade is the life blood of our nation and of necessity we have to be constantly alive to this.

One of our problems of today is the decided risk we run in having so many of our eggs, and such large ones, in the same basket — in our present dependency on the U.S. market, where now 65% of our entire external trade is with the U.S.A. This makes it ever-important for us that while we continue to support our trade with the U.S.A. — and extend it — we also concentrate diligently on greatly improving our trade with Britain — a historical market — and with other nations as well. But it is difficult for us to trade with these countries so long as they shackle dollar trade with their many control features, which they will continue to do as long as they are denied the opportunity to sell their products to us.

Immigration

Another of our problems is that fast-growing though we are, we still have too few people. People are our great need. We must strengthen our economy by accepting large numbers of people — just as did the United States at its period of fastest growth — from the over-populated countries of Europe. This is the most effective way I know in which we can both develop the great natural resources with which we have been endowed and at the same time protect ourselves against any great dip in our economy that could be brought about by outside ocurrences beyond our control and against which, as matters now stand, we have no effective safeguard.

We are working on this problem more diligently than we have for some time and our population has jumped by one-third during the past five years. Significant of the interest of overseas people in settling in Canada is a recent United Nations survey which showed that, for the first time, as many displaced persons wanted to begin life in Canada as in the United States, the traditional "land of opportunity". Indeed, to my mind, the day is not too far away when we will be seeing an influx of some of the youth and the young in heart of the United States crossing the borders to seek their opportunities in Canada in the same way that some hundreds of thousands of our youth went to the United States in the earlier part of the century. Bernard Baruch but a short time ago had this in mind when he said, "If I were a young man today, I would go to Canada." An evidence, perhaps, of some trend in this direction was the entry into Canada last year of close to 10,000 United States citizens exclusive of some 6,000 Canadians who were repatriated. And of those citizens of the United States who have been coming to Canada more than a few have been engineers and skilled workers who have contributed materially to the picture of our development which I have been unfolding.

However, we need to follow a broad and an aggressive immigration policy, and if this is done and our present rate of increase is maintained, I foresee our having a population pretty close to the equal of that of the British Isles within our lifetime.

Conclusion

If, from the story I have given, you believe Canada to be as close to flowing with milk and honey as is any other country today, may I also remind you, the herds need to be tended, and the honey sought and gathered. It is no place for those who do not believe in enterprise and industry. It is no place for the drone.

Do not permit for a moment my story of optimism to lead you to the belief that we are free of problems, because we are not. We have our full share, the same as any other country, but problems are only created to be surmounted and we have a firm confidence, and an abiding faith, that we can and will overcome ours.

There is no feeling on our part that we have approached the conditions of a mature economy. Far from it. Much remains to be done. Irrespective of the still further pushing back of our physical frontiers, there are frontiers of science — the social as well as the physical sciences — to be pushed back by vigorous and enquiring minds.

Furthermore, while we widely realize our good fortune in material goods, we recognize also, I believe, that material riches alone do not make a country great. We realize the hunger, distress, and misery that exist in many other countries and we appreciate that part of our God-given wealth should be employed to assist these less fortunate nations to help themselves. We realize that favored nations can demonstrate to all the world that the forces of evil can never match the humanity of a free society.

So far as our problems are concerned, not enough people and the development of external trade are two to which I have referred — and there are others. But provided we are realistic in facing them; provided we have a devotion to the tasks in hand; and provided we are not unmindful of the grim lessons of history, I cannot foresee any storm clouds, short of war itself, which will retard in any real way our march forward.

The Growing Importance of Internal Auditing

By James P. French, B.Com., C.A.

A general review of the development, techniques and various duties of the internal auditor

INTERNAL auditing has gradually developed over the last twenty years.

1. When it was discovered by the management of certain large corporations that their external auditors were forced to use staff members throughout the whole year to cope with the audit details, it was felt that an economy could be effected by retaining a group of auditors on the company's payroll to perform the same tasks and report their findings to the external auditors.

2. The period from 1935 to the present time has been one of unprecedented industrial expansion in Canada — one in which the annual volume of manufacturing production has quadrupled. This growth brought with it new problems and techniques in the field of accounting. One innovation was the introduction of internal auditors. With the creation of complex, large-scale, dispersed, and diversified operations, management felt an urgent need for on-the-spot current appraisals of the business. To cover the important aspects of branch and departmental operations, the obvious solution was the formation of an internal auditing department. The appraisals were to take the form of internal audit reports.

The field of internal auditing attained recognized professional status in 1941 with the formation in the U.S.A. of the Institute of Internal Auditors. The purpose of this body was the development of certain minimum standards of performance, and the exchange of ideas through the discussion of mutual problems among its members. The growing importance of internal auditing in Canada was evidenced by the unprecedented decision of the Institute to hold its annual conference in Toronto in October, 1949.

General Outline of Duties

It would be extremely difficult to publish any final and conclusive statement of the functions of an internal audit department. For one thing the procedures used are in a gradual but constant state of revision and improvement. Also conditions vary considerably between different industries and even between different companies in the same industry. Nevertheless, the Institute of Internal Auditors has stated that the duties of its members include:

A. Appraisal activities

The three major aspects of this are —

(1) *Ascertaining the degree of reliability of accounting data*

This would include a review of and

report on the adequacy of staff both from a numerical and training standpoint. Management expects information on the requirements of office equipment to perform the work in all departments and the current position in regard to those requirements. Is the cost of additional office-mechanization warranted? The internal auditor should consider and report on any adverse working conditions which would tend to impair efficiency such as staff over-crowding or excessive overtime.

(2) *Assessing the extent to which the company's assets are protected and safeguarded from all losses*

The internal auditor is almost always responsible for counting branch cash and vouching cash sales, charge sales, and money received on account. While these checks are in themselves important, it is of greater value if he considers with care the degree of internal control within the organization and makes any necessary suggestions to improve and strengthen it.

In any manufacturing or selling concern the inventories usually represent a large proportion of the company's total invested capital. They must therefore yield the largest possible return. The rate of turnover i.e. the ratio of average inventory to cost of sales can be used as an indication of over or understocking. The internal auditor should consider:

(a) Physical condition and manner of storage.

(b) Adequacy of insurance coverage.

(c) The manner of costing and the accuracy of price, extensions, and totals.

(d) Protection factors as they apply to the dangers of fire, pilfering, and the action of the elements.

(e) Obsolete or slow-moving merchandise.

(f) Whether the quantities being purchased are the most advantageous with a view to economy.

The internal auditor should take steps to determine if all the fixed assets are properly recorded, identified, and accounted for. As in the case of inventories, an important responsibility in safeguarding against losses is reviewing the extent of insurance coverage. It is self-evident that book figures for buildings are valueless in considering the possible cost of replacement in the event of disaster.

Some discussion with the branch manager on the subject of contingent liabilities can bring to light, on occasion, circumstances which could jeopardize the company's position. Except through the auditor's report, management might remain totally unaware of those circumstances.

(3) *Appraising the extent of compliance with established policies and procedures*

The internal auditor must know the company's policies and directives and be able to interpret them for branch personnel. His is basically an advisory function — he appraises policies but has no power to change them. The changes are made by a responsible official on his advice. The internal auditor, by determining the degree of adherence to established corporate policies, becomes an integral part of the organization's internal control.

B. Recommendations for improvement of various phases of the operations of the organization

(1) *Corporate policies*

Because of the nature of his position, an internal auditor should be able to discover weaknesses in long-established policies. His training and experience must be such that when he is critical of present procedures he can suggest improved ones. Worthwhile ideas can sometimes

be acquired by investigating what is being done by competitors.

(2) *Books and records*

In the course of routine review of records, the audit department should give some thought to keeping the company modern in its accounting methods. The effective use of internal auditing is limited to large corporations with widespread activities including various sales offices, branches, plants, or subsidiaries. There will therefore be, in all probability, a considerable volume of information recorded — a job which can be done more rapidly and at less cost by up-to-date machine methods.

(3) *Standards of performance*

In this field the internal auditor performs his most onerous duties and is best able to help management. He must appraise the training, qualifications, and suitability of employees in the more important positions. This function is in reality a check on "efficiency performance". In considering output and the procedures and methods in use, he will need as a guide some sort of efficiency standard such as one based on a minimum acceptable performance. In the event of a definite weakness in the performance of duty, an adverse report to management must be made.

Requisite and Desirable Qualifications

In the selection of the best-suited personnel to form an internal audit department, consideration must be made of suitability under two categories:

(1) *Academic training and knowledge*

A good internal auditor must be a fully-trained and experienced accountant. The graduate with considerable experience is better equipped to assess the value of the accounting data he is reviewing and the strength of the internal control. He is also better qualified to discover possible irregularities.

As the internal auditor is a member of the management group his formal education should not be too dissimilar from other management positions. Ability to express himself orally or in writing with equal clarity is imperative. A broad company-wide point of view is necessary. This suggests that a sound basic education of a general nature is required before an internal auditor can readily accept specialist duties. His loss of perspective will be minimized as each specialist assignment is viewed in its relationship to all others.

The general basic training of a public accountant supplies a strong background in auditing procedures and a knowledge of the preparation of financial data, reports, and statements. This type of training qualifies a man admirably for internal auditing work. However, the best source of men for internal auditors comes from within an organization itself. Every company has its own problems and accounting intricacies which can best be learned through several years experience and service.

(2) *Personality characteristics*

Patience and perseverance are essential in the make-up of any internal auditor. The reason for this is the routine nature of a large portion of his work, and the need for him to press his investigations vigorously to a satisfactory conclusion should his suspicions become aroused.

Keen powers of perception are needed as well as an unbiased mind. In the detection of fraud an astute insight is often imperative. The internal auditor who allows himself to become a ticking machine, without thinking beyond the books themselves, is not as apt to detect defalcations. In assessing the performance of duty and the value of record he must do so with a fair and open mind. In the words of Diderot "Ignorance is less remote from the truth than prejudice".

Tact is necessary if the internal auditor is to gain the cooperation of personnel in the departments he visits. A personable, non-antagonistic manner is always less likely to create a barrier of resentment. However, when it is found that the auditor cannot perform necessary functions without creating unpleasantness with a department head, he must remember that his duty comes first and that he will be supported in his actions.

Independence and the ability to make decisions are important necessary qualifications. By nature he should be of an independent mind. His work will often take him far afield from the home office where he must be able to quickly make decisions without the assistance of his department head.

Finally, the best type of internal auditor is a reticent, non-fraternizing individual. The unique position which he holds gives him access to certain facts and information which he must not disclose. To do so would be a grave breach of conduct. When it is necessary for him to attend social functions with a departmental head this fact must not sway him from his independent and critical attitude. Periodic alternating of assignments among internal auditors will minimize the factor of non-independence and have the additional benefit of a fresh opinion on the subject.

Status Within the Organization

In some companies the function of internal auditing comes under the sphere of the controller's department. In others the reports are made to the managing-director or his executive assistant. To adequately accomplish his function of keeping management informed, the auditor must be free from undue influence as to the extent of his audit and the contents of his report. To be of optimum value he must be free from fear of any disciplinary action by any department head upon whom it is his duty to report. Furthermore, whatever the organizational set-up, he should be responsible to a sufficiently high official that when his reported findings indicate necessary action, it can be taken. While the more independent the internal auditing department becomes the more efficient it will be, it should be borne in mind also that the heavier will be its responsibilities.

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The internal auditing department should never be responsible for the preparation of any accounting record or any other operating duty. Should this occur, the same group would immediately be assigned the task of recording and checking the same information.

The Need for Harmony with External Auditor

Although the internal auditor performs many of the same functions as the public accountant, he does so from the point of view of aiding management. The latter's duty continues, of course, to report to the shareholders on the financial position of their company.

The external auditor is assisted in two ways by the existence of internal auditors within any organization:

1. He may be relieved of a substantial volume of routine audit checking. By reviewing the internal audit program and working papers and assessing their value, duplication of effort can often be avoided. He must not consider the work of the internal auditor as a substitute for his own efforts. As the field of internal auditing continues to develop, there will

undoubtedly be a greater shift of responsibility for the costly procedure of detailed checking, leaving the public accountant more time for consideration of general policies and principles.

2. By perusal of the internal auditor's reports he can gain some assistance in the appraisal of the internal control within the company. Through continuous review of the company records, weaknesses are more rapidly remedied than can be done by an annual visit from external auditors.

When any company goes to the trouble and expense of establishing an internal auditing department, the external auditor should cooperate by (a) availing himself of the data and information so compiled, and (b) giving full recognition of the internal auditor's review and alter his programs accordingly.

In some organizations there is apparently still no satisfactory working arrangement between the two groups. It is fortunate, however, that with a very few exceptions, independent auditors appreciate the great and growing value of internal auditing. The internal auditors themselves can do much to promote a pleasant relationship by bearing in mind that the external auditor cannot always accept their figures. On occasion he must for his own satisfaction verify the accuracy of figures and information which the internal auditor has prepared and knows to be correct.

Conclusion

Three procedures are here recommended which internal auditing departments must adopt in order to enjoy the fullest appreciation for their efforts:

1. The audit programs should be put under regular review and revision by the department for the purpose of improving the benefits received by the company Ample coverage of the policies and financial records cannot be accomplished with the same program over a lengthy period. The staff of any branch should never be lulled into the feeling of assurance which results from an intimate knowledge of what will transpire upon the occasion of the annual visit from the internal auditors.

2. The audit reports prepared for management should be worthy of the amount of effort that has gone before. A busy executive must be able to get the point by a clear, clever presentation. It is pointless to mention minor clerical errors. Abusive remarks about any person or department have no place in any audit report. What then should be the contents of an ample report? The information which management will expect to obtain includes (a) an appraisal as to whether general accounting standards are good or bad, (b) an opinion of the adequacy of the internal control to protect cash and other assets of the company, and (c) current information as to branch operations, e.g. Are branch sales up or down? What is the status of uncollected receivables? Are production lines operating efficiently and waste kept to a minimum?

3. The internal auditing department should be an "economy-minded" group. This should be so particularly in the matter of production and operating costs. Some observers feel that by economy recommendations the department must save the company at least an amount equal to its own costs, in order to justify itself. Others, who feel that reduction of costs is not a primary duty of the internal auditing department, must concede that any suggestions which will result in a saving to the company are always welcomed by management.

Dilution

By S. D. Reavely, B.Bus.Admin., C.A.

When convertible bonds are turned into common stock, what is the effect on the equity of the common share?

THE value of a common stock is said to be "diluted" if there is an increase in the number of shares without a corresponding increase in assets and earning power. Such a condition may or may not exist when convertible bonds are turned into common stock. This is an attempt to explain the position when this happens and to determine the importance of dilution from the standpoint of the common shareholder and management.

Why Convertible Bonds?

When convertible bonds are issued, their conversion rights constitute a claim upon the treasury stock or other security of the company. The company is compelled to recognize this claim at the bondholders' demand, whether or not it is convenient or desirable. The question arises as to why a corporation should issue such securities at all. The answer is that all securities are sold for the purpose of raising capital, and the corporation must issue such types as will prove most readily marketable and bring the best price. Often a company cannot, through either its stocks or bonds, offer the three features generally desired by the purchaser, namely, adequate income, lack of risk, and control, or any of these in a degree to make the security desirable. In such a case, a convertible bond may fit in admirably. It gives safety of principal and a certain ratio of income; it gives the holder the privilege of later trading it in for stock, should the company prosper to the point that the stock yields a high return; and it is reasonably secure, the control coming indirectly with the other desirable features of the improved stock.

As far as the corporation goes, the conversion of bonds into stock furnishes a convenient and relatively easy way of getting rid of bonded indebtedness and the fixed interest charges incident thereto. It requires no cash payment but simply a further division of the ownership. Since conversion is rarely made unless the company is in a growing or prosperous condition, it does not work a hardship on the old stockholders.

Convertible bonds are made convertible at some given ratio. The simplest ratio is par for par, that is, one $1,000 bond is converted into ten $100 shares of stock. Sometimes, the ratio is other than par. The provision may be that the bonds are convertible into stock at 110 or at 120 or

at any specified figure. This means that the bonds may be converted into stock valued, for conversion purposes, at $110 or $120 per share, i.e. that $1100 or $1200 worth of bonds, face value, will be required to get $1000 worth of stock, face value. By watching the relative market prices, the bondholder may be able to convert without loss, or at a gain, in spite of the fact that he gives a larger face value than he receives.

How Market Value is Determined

When the market values are such that the bonds can be converted without loss, they are at their conversion point. Thus, if bonds are converted into stock at $120 and the stock is selling at $102 per share, the bonds will be at their conversion point when they are selling at $85, which is 10/12 of 102. In this case, 12 bonds, each with a par value of $1000, would be given for 100 shares of stock each with a par value of $100, but with a market value of $102. Therefore, the 12 bonds selling at $85 would be worth $10,200, on the market, the 100 shares of stock into which they are converted would at 102 have the same market value of $10,200, and the conversion can be made without loss. If the bonds are selling above $85, the conversion, if made at all, will be made at a loss. If they are selling below $85, the conversion will be made at a profit.

Market prices of convertible bonds are not governed as much by the investment value of the security as are the market prices of non-convertible bonds, because the convertible bond prices are influenced to a considerable degree by the market price of the stock into which they are convertible.

The true investment value of a bond is the value at which it will earn the current rate of interest. Thus, if money is worth 6%, a 6% bond earning $60 interest will be worth, as an investment, $1,000. If money is worth only 5%, the same bond would be worth $1200 as an investment. If money is worth 7%, the same bond would be worth $857.15 as an investment. The market value of an ordinary bond will ordinarily remain quite close to its true investment value, but the market value of a convertible bond may follow the market value of the stock into which it is convertible to a point far above the investment value. For example, a certain bond is convertible into stock par for par and has an investment value of $1,000. If the stock goes up on the market to $120 a share, the bond should go up in about the same proportion, i.e. to about $1200, because it is exchangeable at any time for stock which can actually be sold for that amount. When the market price of the stock begins to drop, the market price of the bond will drop with it. The stock, however, may go down and down indefinitely, whereas when the bond has declined as far as its true investment value, in this case $1,000, it might decline no further. Normally, the market price of convertible bonds will advance or decline along with the market price of the stock into which it is convertible, advancing with it to any extent, but declining with it only to the level of the true investment value of the bonds.

Consider the point of view of the common shareholders who own the corporation prior to the issue of the convertible bonds. Has an injustice been done them by admitting to the corporate enterprise newcomers who are both creditors and possible future shareholders? It would appear that both the old shareholders and the corporation itself are the gainers, whatsoever the final results of the conver-

sion. It is certainly true that the corporation — and the common shareholders who are ultimate heirs of any good or any ill that befalls the corporation — gains something by being able to obtain present capital in return for a gamble on the future.

A Typical Case

Take a typical case. The 20-year 6% bonds of a corporation, on the common shares of which no dividends are being paid, can be sold for 90. The underwriters suggest that they will pay $94½ for the bonds if they are made convertible into 100 shares of the common stock of the company which is then selling at $5½. By adding the conversion privilege, the company can receive $45 more for each $1,000 bond, or in terms of interest and amortization the company can borrow at a 6¾% rather than a 7¼% rate. For this $45 the corporation gives nothing. It does not give even a shadow of value. The privilege of buying for $9.45 that which can be bought on the open market for $5.50 is, in terms of present worth, nothing. Should the corporation be able to sell the shares at the time for $9.45 per share, the equity of the common shareholder would become more concentrated rather than diluted. What the corporation has done is to sell nothing for something — an excellent move from the standpoint of the common shareholder.

The corporation may be very successful. Its stock may rise not only from $5.50 to $9.45 per share, but it may go even to, say, $19. If so, the bondholders most likely would convert their holdings. An important contributing factor to this success was the increased earning power from the investment of the proceeds of the bonds sold to the underwriters at $94½. At the time of conversion the converting bondholders would be getting a $19 package for which the corporation received $9.45. But this is looking back. If these same convertible bondholders had had foresight equal to hindsight, they could have bought the same package, at the time they purchased the bonds, for $5.50 on the open market — and the corporation would have received nothing. Under such circumstances they would have made an even greater profit. Certainly neither the corporation nor its shareholders have reason to complain because the corporation received a share of the newcomers' profit, at the time the bonds were sold.

Mr. S. D. Reavely, B.Bus. Admin., C.A., is a member of the Quebec Institute. He is presently the chief travelling auditor of the Canadian Pacific Railway Company.

Also, the corporation may not be successful. During the whole conversion period, the common stock may not rise above $6 a share. No conversion will occur. And here again neither the corporation nor its old shareholders have reason to complain. When the convertible bonds were sold, the corporation received $45 more for each bond than it was worth as a mere investment, simply because the bondholders were given certain rights of conversion which were, at the time, without value and which never acquired any value. Certainly this was not a bad bargain for either the corporation or its common shareholders.

The whole matter of dilution of the equity of the present shareholders in such instances seems to stem from a failure to distinguish between expediency and justice based on foresight, and expediency and justice based on knowledge obtained after events have shaped the circumstances. In any event, any attempt to find and trans-

late dilution through conversion into a figure would be doomed to failure from the start. The shrinkage, if any, in the equity of the common share occasioned by the admission of the newcomers into the ownership would have to be considered with the changes in the market value of the stock, and the changes in the earning capacity attributed to the use of the new money would have to be weighed against the position as it might have been if the new money had never been introduced into the business. Accuracy of computation appears to be remote.

As stated previously, conversion is not likely to take place unless there is considerable improvement in the company's position and hence the objections to dilution through conversion appear to have more academic value than practical significance.

BACKROOM PROSPECTUS

Proposing the toast to the Institute of Chartered Accountants in England and Wales at the annual dinner of the Northern Society of Chartered Accountants, Sir James Duff, vice-chancellor of the University of Durham, said he had been told that accountants were retiring people who kept themselves in the background — did useful work, no doubt, but were essentially "backroom boys". Continuing in this vein, Sir James said:

> "Chartered accountants — how odd these adjectives that go with professions are! Qualified doctors, beneficed clergymen, called barristers, certificated teachers (one must not call them certified), the landed gentry (you can see them flapping their tails in the landing net, much the position they are in), chartered libertines — though I don't think that libertines have ever been granted a Royal Charter, and who has ever heard of anyone chartering a libertine? — and chartered accountants."

Sir James continued:

> "The growth of your profession has been a silent growth to this extent — you are backroom boys, though you occupy all the most prominent positions but, silent or not, I suppose that within our lifetime your profession has grown not merely to the status of a great profession but one which nowadays . . . . is at least equal in influence and importance to any one of the older professions.
>
> "Nor can I see that tendency altering — indeed, I see it increasing. It is a product, I suppose, of the managerial revolution. Now we do not keep our money in stockings any more, or in holes up the chimneys of our houses; now, the wealthier you are the less likely you are ever to see the coin of the realm! I see nothing to stop your profession from ultimately dominating the whole of our commercial, industrial, and business life, and I will say that I would rather see your profession dominating it than some other professions I could think of."

— *The Accountant*, November 20, 1954

Accounting Research

By Gertrude Mulcahy, B.A., C.A.
The C.I.C.A. Research Department

CAPITAL STOCK — (continued)

THIS month we are continuing our discussion of specific examples of the statement presentation and accounting techniques adopted by Canadian companies with respect to their capital stock.

In order that a reader may readily assess the relative value and rights of each type of share issued, it is imperative that the financial report disclose clearly any current changes in the capital structure of the company.

The examples selected from 1952 financial reports illustrate some of the procedures relating to the current redemption of capital stock.

Example 5 — Redemption of Shares by a Provincial Company

The balance sheet presentation of example 5 discloses (by deduction) that 1,657 shares of the 4% cumulative redeemable sinking fund preferred stock have been redeemed during the year, the preferred share capital being decreased by $82,850. No further reference is made to this redemption in the annual report other than in the statement of source and application of funds included in the directors' report, where $82,850 has been set out as a disposition of funds resulting from "Preferred stock redeemed and cancelled", indicating that the shares were redeemed at par. Being a provincial incorporation, this company did not segregate a portion of the accumulated net earnings as a designated capital surplus, arising from the redemption of preferred shares.

Example 6
Redemption at a Premium

In example 6 the total stated value of the capital stock has decreased by $26,625, the par value of the 1,065 5% preferred shares purchased for cancellation during the year. The adjustments set out in the statement of earned surplus discloses that a premium of $120 was paid on the purchase of these shares for cancellation. Under the provisions of s. 61 of The Companies Act (Canada) a transfer was made from earned surplus to the "Preferred Stock Purchase Reserve" of an amount equal to the cost of the shares purchased for cancellation. This transfer is reflected in the balance sheet by an increase of $26,745 in the preferred stock purchase reserve. The accounting procedure followed by the management of this company involves an aggregate charge against "ascertained net profits" in respect of the premium equal to twice the amount of the premium.

Example 7
Redemption at a Discount

From the information set out in the balance sheet and the adjustment of capital surplus for "Discount on redemption of Preferred Shares — $3,726", in example 7, it can be determined that 810 of the $50 par value preferred shares have been redeemed during the year at $45.40 per share. In order that the redemption will not be deemed to be a reduction of share capital within the meaning of secs. 49 to 58 of the Companies Act (Canada) the company has made a transfer from "Earned Surplus" to a designated capital surplus. However, in this case, it is difficult to determine the basis of calculation of the $48,924 so transferred. The addition to capital surplus of $12,000 represents the restoration to surplus of a "Sinking Fund Reserve for the Redemption of Preferred Shares" set up in the previous year by a charge to earned surplus. Although the share capital of the company has been reduced by only $40,500 during the current year, the capital surplus has increased by $64,650, which is the total of (1) the transfer from earned surplus, (2) the transfer from the sinking fund reserve, and (3) the discount on the redemption of preferred shares.

Reference to the financial statements of a prior year and the subsequent year gives rise to the assumption that there were 12,000 preferred shares issued and 1,310 redeemed rather than 11,500 and 810 respectively. If this were so, the par value of preferred shares redeemed would be $65,500. The opening balance of the capital surplus account is made up of $114,990 of additional paid-in capital and a further amount of $850. This latter amount, when added to the $64,650 transferred to the capital surplus account during the year, gives a total of $65,500.

A comparison of the 1951 and 1952 statements of this particular company brings to light the fact that an additional 100 common shares had been issued during the year, with an increase in the stated value of this class of shares of $2,000. However, the management has made no mention of this transaction in their 1952 annual report. Therefore unless a reader refers back to the 1951 financial report he will be unaware that additional shares had been issued during the year.

Example 8
Sinking Fund Redemption

From the information disclosed in the balance sheet, the statement of profit and loss, and the directors' report, in example 8, it can be determined that 41,367 of the 4% redeemable sinking fund preference shares with a par value of $1,034,175 were purchased and redeemed during the current year for $975,551. The "Capital surplus — arising from the Redemption of Redeemable Sinking Fund Preference Shares" set out in the balance sheet is equal to the current par value of the preferred shares redeemed to date. The current increase is equal to the current decrease in the par value of the capital stock outstanding. The figure "Sinking Fund Reserve for Redemption of 4% Preference Shares — $11,964" represents the balance of the provision set aside out of accumulated earned surplus which has not yet been applied to the purchase and redemption of the preferred shares. Unlike the procedures followed in example 6, the annual transfer from earned surplus in respect of the redemption of capital stock is not dependent upon the number of shares redeemed during the year, because of the appropriations made to and from the sinking fund reserve.

EXCERPTS FROM PUBLISHED FINANCIAL REPORTS — 1952

Investment in Subsidiary Companies

Example 5

In the Balance Sheet

	December 31 1952	December 31 1951
SHAREHOLDERS' EQUITY:		
Capital Stock:		
Four per cent. Cumulative Redeemable Sinking Fund Preferred Stock (Par Value $50.00 per share): Authorized and outstanding—1952-151,158 shares; 1951-152,815 shares	$ 7,557,900	$ 7,640,750
Common stock, no par value: Authorized—290,660 shares; issued—257,260 shares	128,630	128,630
Capital Surplus	692,350	692,350
Reserve for Contingencies	1,000,000	1,000,000
Earned Surplus	17,169,405	14,163,446
	$26,548,285	$23,625,176

Example 6

In the consolidated Statement of Earned Surplus

Deduct:	
Appropriation to preferred stock purchase reserve	$ 26,745.00
Premium paid on purchase for cancellation of 5% Preferred shares	120.00

In the consolidated Balance Sheet

			January 31, 1952	January 31, 1951
CAPITAL STOCK:				
Authorized:				
40,000	six per cent, redeemable preferred shares of a par value of $25.00 each	$1,000,000.00		
80,000	five per cent redeemable preferred shares of a par value of $25.00 each	2,000,000.00		
750,000	common shares without nominal or par value			
Issued and fully paid:				
40,000	six per cent, preferred shares	$1,000,000.00		
76,990	five per cent, preferred shares (Note 2)	1,924,750.00		
625,000	common shares	625,000.00	3,549,750.00	3,576,375.00
PREFERRED STOCK PURCHASE RESERVE			126,629.37	99,884.37
CONSOLIDATED EARNED SURPLUS			5,159,809.31	4,714,505.68

NOTE 2: 1,065 shares purchased for cancellation during year ended January 31, 1952.

Example 7

In the Balance Sheet

CAPITAL STOCK AND SURPLUS

CAPITAL STOCK

Authorized:—
10,690 Cumulative Redeemable Sinking Fund Preferred Shares of $50.00 par value each, carrying an annual dividend of $2.12 per share
50,000 Common Shares of $20.00 par value each

Issued:—		
11,500 Preferred Shares	$ 575,000.00	
810 Redeemed and Cancelled	40,500.00	
10,690 Preference Shares Outstanding	$ 534,500.00	
49,600 Common Shares	992,000.00	
	$1,526,500.00	
CAPITAL SURPLUS:	$ 180,490.00	
EARNED SURPLUS	1,559,360.37	
	$1,739,850.37	3,266,350.37

In consolidated Statement of Surplus

CAPITAL SURPLUS

Balance 31st October 1951 (including additional paid-in Capital of $114, 990.00)		$ 115,840.00
Add: Discount on redemption of Preferred Shares		3,726.00
Transfer from Sinking Fund	$12,000.00	
Transfer from Earned Surplus in respect of the Redemption of Preferred Shares	48,924.00	
		60,924.00
Capital Surplus 31st October 1952 (including additional paid-in Capital of $114,990.00)		$ 180,490.00

EARNED SURPLUS

Deduct:

Transfer to capital surplus in respect of the Redemption of Preferred Shares as required by Section 61 of the Companies Act 1934	$ 48,924.00

Example 8

In the consolidated Balance Sheet		1952	1951
Liabilities			
RESERVES			
—			
—			
Sinking Fund Reserve for Redemption of 4% Preference Shares			
—		11,964	87,515
—			
—			
CAPITAL			
6% Cumulative Preference Shares, par value $4.86-2/3 each			
Authorized: 1,650,000 Shares	$8,030,000		
Issued: 1,650,000 Shares		8,030,000	8,030,000
Redeemable Sinking Fund Preference Shares, par value $25.00 each*			
Authorized: 600,000 Shares	$15,000,000		
Issued: 400,000 Shares* $10,000,000			
Less:			
Redeemed 54,280 Shares* .. 1,357,000			
Outstanding: 345,720 Shares		8,643,000	9,677,175
(* 4% Cumulative Series)			
Common Shares, par value $5.00 each			
Authorized: 10,800,000 Shares	$54,000,000		
Issued: 9,670,532 Shares		48,352,660	48,352,669
SURPLUS AND GENERAL RESERVE			
General Reserve		5,000,000	5,000,000
Capital Surplus—arising from Redemption of Redeemable Sinking Fund Preference Shares		1,357,000	322,825
Consolidated Profit and Loss (Earned Surplus)		7,474,104	7,095,582
		$156,525,586	$150,612.059

In Consolidated Profit and Loss Statement

	1952	1951
(in surplus section of combined statement)		
Deduct:		
Provision for Redemption of 4% Preference Shares	900,000	150,000

In Directors' Report

In accordance with the conditions attaching to the 4% Redeemable Sinking Fund Preference Shares a minimum of $150,000 was required to be set aside for redemption of these shares. The amount actually set aside in 1952 was $900,000 which, together with the balance at the end of 1951, was almost completely applied during the year to purchase and redeem 41,367 shares of this issue, leaving only $11,964 available for this purpose at the end of 1952.

A Letter from a Reader

Montreal, Sept 2, 1954

RIGHTS OF
UNPAID VENDORS UNDER THE CIVIL LAW

Sir: I would like to commend Mr. Moller's article "How Accountancy Influences Credit Policy" [*August 1954 issue*] as worth reading and rereading. His recommendation against uncritical reliance upon bank references, especially in the case of small branch bank managers, is sound and valuable advice, as frequently demonstrated by experience.

In this connection may I be permitted to make a comment on the position of the bank under s. 88 of the Bank Act in relationship to the rights of the unpaid vendor.

In the illustration narrated by Mr. Moller he describes merchandise shipped on Monday, and not paid for, as becoming the collateral of the bank. The inference appears that once delivery is made, even though the merchandise has not been paid for, the bank, under s. 88, acquires a right overriding that of the unpaid vendor.

Under The Civil Code of Quebec, Articles 1998-9, the unpaid vendor of a thing has two privileged rights: (1) a right to revendicate and (2) a right of preference upon its price. The right to revendicate must be exercised within eight days after delivery. In the case of insolvent traders these rights must be exercised within thirty days after delivery.

The question of priorities as between the bank, secured under s. 88, and the claims of unpaid vendors on goods covered by security was fully discussed by Justice Gibsone in *Re March and Buzell*, 11 C.B.R. 463. It was held:

1. It is not the purpose or effect of s. 88 to transfer to the bank more rights in the merchandise than the customer himself has; it is only the rights in the merchandise which the customer himself has which are transferred to the bank by security, the rights of third persons in the merchandise are not affected or diminished by the act of the customer in giving the security receipt to the bank.
2. If the price is not paid, within eight days in ordinary cases, within thirty days in bankruptcy, the seller is entitled to recover the thing sold if it is entire, in the same condition, and not bought and paid for by a third party: this right of the vendor to recover the thing sold constitutes a lien upon it.
3. The bank's claim is that by s. 89(2) its security receipt has precedence over these unpaid vendors. Section 89(2) grants to the security receipt precedence over the claim of an unpaid vendor, but not over the lien of an unpaid vendor unless this lien was "acquired" by the unpaid vendor without the knowledge of the bank. The lien referred to as "acquired" by the unpaid vendor is not the lien attached by law to the fact of the sale (such as claimed by the present unpaid vendors) but to a lien independently (and presumably subsequently) acquired. The bank's contention in this respect is unfounded.
4. The unpaid vendors are entitled to be collocated in preference to the bank for the value of their merchandise existing at the date of the assignment.

Perhaps one of your readers may be prompted to complement the above by outlining the legal position in the Common Law Provinces.

S. KOLOMEIR, B.A., C.A.

Practitioners' Forum

Conducted by Geoffrey H. Ward, C.A.

AMERICAN INSTITUTE OF ACCOUNTANTS 1954 ANNUAL MEETING

THIS year the American Institute held their convention at the Waldorf Astoria Hotel in New York. New York is quite handy to Toronto, so I took a week off to take in the sights and attend the convention. There was much to interest smaller practitioners as many sessions were conducted specially for their benefit concurrently with other sessions for members of larger firms. Here are some notes on matters discussed at the meetings.

PROFESSIONAL FEES

Mr. John G. Moody, C.P.A. of Vermont was the speaker. The members of the panel were from all parts of the United States and their firms varied in size from one to 25 persons. Hourly rate scales were found to vary considerably according to location and the size of the city. Clients generally expect to pay lower fees to country accountants who, they are aware, pay lower salaries and have lower living costs than city accountants. The rates surveyed, which were all for small firms, averaged as follows:

Juniors	\$3.50 per hour
Intermediates	4.50 per hour
Seniors	5.75 per hour
Principals	8.50 per hour

Rates ranged from 1 2/3 to 2 1/2 times salary costs and generally 60% of fees is considered to be salary costs. The general tenor of discussion at the meeting was that the fees reported were too low and that accountants' fees should be higher. Several accountants present commented that their fees were much higher than those reported by the survey.

A tendency to bill more frequently has developed, particularly among the smaller firms. Whilst the prewar practice was to bill annually, during the war the custom started of billing monthly, and it is still being maintained. One practitioner reported that 50% of his clients are billed at the end of the year's work, 25% monthly, and 25% at irregular times as special circumstances require.

About 60% of the firms charged travel time during office hours only, 20% also charged travel time outside office hours, and 20% made no charge for travel time. As a minimum it was felt that unavoidable travel time during office hours should be charged to the client.

Accountants base the majority of their fees on *per diem* rates. Some fees are fixed, but only in a narrow area of practice. There is a growing tendency when billing to show one amount

only. Most firms have never had to bring suit to collect fees and yet extend considerable credit to clients. They have no fixed credit policy and allow very flexible terms depending on circumstances.

One accountant declared that there was definitely money to be made by running a bookkeeping service. His firm, he said, will take this work on a flat fee basis, but the work called for is set forth exactly in a contract and anything additional is charged extra. Their salary costs are 50% of their fees and their rates vary from $3.50 to $8.50 an hour with an average billing rate of $5.00 an hour. Quite a contrast with what the local practitioner in Canada can expect!

As to the propriety of charging according to ability to pay, it was felt that it was more professional to vary fees according to the value of what is done and that there is nothing wrong in charging more than the regular hourly rates if the work is of particular value to the client.

All accountants apparently receive numerous requests for reduced billing from "so-called" and "actual" charitable institutions. The argument was presented that these institutions pay regular prices for most commodities they need, so why not proper fees? If the public accountant wishes to make a charitable donation he can do so in the regular manner.

Staff Training

Mr. Harold L. Childs C.P.A. of Utah was the speaker. One firm has an indoctrination talk for new staff recorded by a partner on a tape recorder. All new employees listen to the tape and then ask questions. This saves the partner time and insures that each new employee hears a complete talk.

Regular staff meetings were recommended as being very valuable and important. Not very much formal staff training is being done by the smaller firms so staff meetings are needed to fill this gap. Usually meetings are not held either in the peak season of January to March or during July and August because of holidays. Attendance at meetings is usually not voluntary as the time is considered part of the regular work week. A suggested time for meetings was one hour a week, from 8 to 9 o'clock Monday mornings.

The choice of material is made with the purpose of the meetings in mind. The meetings are designed to help the staff men get in as many productive hours as possible. Therefore they try to teach them things that can be used immediately in their work. Quite a lot of time is spent on taxes, particularly the latest revisions to the law. The small firm does not need to break the staff down into various levels or strata. Those who have had experience say that these meetings are well worth the time spent — that staff meetings pay.

Auditing Procedures

Mr. H. W. Bevis C.P.A. of New York reviewed the history behind the 1954 publication of the pamphlet "Generally Accepted Auditing Standards" and discussed the history of the extension of auditing procedures to include the attendance at physical stock taking and the confirmation of accounts receivable. Of particular interest was his discussion of the objections made by practitioners to these additional procedures, or as he put it, the basic fears of practitioners who hesitated to adopt these procedures. These were:

Q. Was the auditor's responsibility increased?

A. This view is due to a lack of under-

standing; one must appreciate that the client is still basically responsible for the quantity, quality, and condition of his inventories.

Q. Were the accountants capable of handling this work?

A. The additional year end peak work load was overcome by increasing the interim work and carrying out much of the verification at other than year end dates.

Q. Would the clients not object to this additional work and its cost?

A. Clients have come to appreciate that the auditor's participation will help to improve inventory valuation and receivables control. Education of clients may be needed in some cases to overcome their objections.

partment and published under the title "Long Form Report Practice". Price is $3.

When preparing reports for smaller businesses there is a great need for information as management is relying more on the independent public accountant and less on internal personnel for financial data. Accordingly long form reports are more common for such clients.

One of the outstanding needs is for standards to compare with the client's results. These can sometimes be obtained from trade sources. For example the pamphlet "Expenses in retail businesses" which the National Cash Register Company makes available free to its clients is a valuable source.

Reports may include a detailed current balance sheet, with emphasis on the latest year's figures, and also a condensed comparative balance sheet showing amounts of changes, with emphasis on comparison. Some reports include data on the history of the organization such as date and place incorporated, shareholdings, and comment on the insurance coverage. The practice 15 years ago was to set forth what the auditor did — this is felt to be no longer necessary in view of the generally accepted auditing standards. However, some credit grantors still want to know whether or not the accounts receivable were confirmed and the inventories inspected.

The editor of this bi-monthly column cordially invites correspondence from his readers.

Q. Was not the value of these procedures overrated?

A. This may have been the case to some degree. Nevertheless they are still worthwhile procedures. They have made manipulation or misstatement just that much more difficult.

Q. Are these requirements always practicable?

A. Sometimes they are not but in those cases alternative procedures must be carried out.

Reports

An interesting discussion was held on long form reports. The American Institute has published a lot of material on this. They publish annually "Accounting Trends and Techniques in Corporate Annual Reports" for $10 which covers published reports. In 1953 an analysis of 52 long form reports was made by their research de-

Accountants' Own Records

Mr. J. T. Koelling, C.P.A. presented this paper. His firm uses an accrual basis of accounting. The figure for work-in-process is arrived at on the following monthly work sheet.

ANALYSIS OF GROSS INCOME

	Month of September 1954	Month of September 1953
Number of productive personnel	16	14
Gross potential income	$20,000.00	$18,000.00
Less: Non-productive time (schedule 2)	3,820.00	3,140.00
Net potential income	$16,180.00	$14,860.00
Less: Fee variations	620.00	220.00
Gross income	$15,560.00	$14,640.00
Plus work in process September 1	42,640.00	38,760.00
	$58,200.00	$53,400.00
Less: Fees invoiced	12,480.00	11,820.00
Work in process September 30	$45,720.00	$41,580.00

COMPUTATION OF WORK IN PROCESS

September 30, 1954

		Principal	Supervisor	Senior	Junior
Total hours (From control sheet of time ledger)		1,060	1,316	4,018	2,483
Less: Non-productive time accumulated		420	211	476	176
Productive time		640	1,105	3,542	2,307
Standard billing rate		$ 10.00	$ 8.00	$ 6.00	$ 4.00
Amount — Total	$45,720.00	$6,400.00	$8,840.00	$21,252.00	$9,228.00

Gross potential income is calculated by multiplying the hourly rates for the staff employed times the hours available each month.

The gross potential income minus the non-productive hours and fee variations should equal actual fees when adjusted for work-in-progress. The monthly analysis of non-productive time is compared with other periods for control purposes. Column headings on this analysis are: Name, Key letter, Hourly rate, Totals, Unassigned, Personal, Illness, Vacations, Holidays, Public Relations, Administrative, Routine. The figures shown are the dollar value of the time charged to each classification. The fee variations are the differences between fees at standard rates and actual fees billed.

Here are several unrelated comments as to procedures found to work well in their offices made by accountants present at this meeting. New engagements have been expedited by the use of a standard memorandum. The work can be assigned to any senior member of the firm. Space is provided for showing the wording to use when billing.

The slip system form of time sheet is becoming quite popular. There is a recent trend to the use of variable rates for the same man for different types of work and for different men although their salary may be the same. These flexible rates have a good psychological effect on the staff as they take pride in being able to charge their time out at the higher rate. When this factor is taken into account in fixing annual bonuses it has a tangible as well as psychological benefit for the staff.

One accountant tells his clients that

that their hourly rates are 1/10 of 1% per hour of a man's annual salary. They try to close new engagements on an hourly basis. However, if pressed they give a maximum fee quotation but always make it quite high. They try to limit the principal's time to one tenth the total time on a job.

At first glance a cash basis of accounting may appear to be a way of deferring taxes. However upon closer analysis you may find this is not the case. There is some tendency to pyramid income with a cash basis, and cash may come in spasmodically and give one year's income an undue boost. Also in the first year of operations, even on an accrual basis, one's income can be expected to be low and hence in the low tax brackets.

PROCESSING PERSONAL TAX RETURNS

IN *The Journal of Accountancy,* February 1953, S. Jay Lasser, C.P.A. of New York City, writes on "Procedures to Organize Preparation of Individual Tax Returns in a C.P.A.'s Office". He describes a plan by which the handling of a large volume of individual income tax returns during the peak month is reduced to a systematic and orderly routine. His plan saves time, ensures that the returns are done carefully and promptly, and reduces the overtime strain on employees to a minimum.

As you can imagine, considerable planning is required in order to achieve all this. Preliminary to the actual preparation of the returns a five step program is carried out, as follows:

1. Listing of the individual taxpayers for whom returns are to be prepared.
2. A list assigning the gathering of data to respective staff members or partners.
3. A list assigning the preparation of returns to respective staff members or partners.
4. Heading up a tax work sheet for each client. Then reviewing prior years' and current tax files for basic entries for the tax work sheet.
5. Gathering data.

The tax work sheet is important. This is basically a questionnaire on which information required for completing the return can be shown. However, it is much better for this purpose than a plain sheet of paper or a blank tax return. Ample space is provided for answers and special leading questions are asked regarding points to be watched for. As the form illustrated in *The Journal of Accountancy* is for United States taxes it cannot be readily used in Canada, but a competent tax accountant could no doubt prepare one for Canadian use. Any volunteers?

TAX EVASION AND THE CONFIDENTIAL RELATIONSHIP BETWEEN AUDITOR AND CLIENT

IN the March 1953 issue of *The Journal of Accountancy* this subject is discussed in the editorial. In view of the confidential relationship between an auditor and his client an embarrassing situation arises when the auditor learns that his

client has been guilty of income tax evasion. Legal considerations enter the picture, because discussions between auditors and clients are not "privileged" as they are in the case of lawyers.

For the auditor to be guilty of illegal conduct it is felt that there would have to be some affirmative act of concealment in addition to mere failure to disclose. The auditor might become an accessory after the fact if when challenged by the income tax assessors he neglected to report the true facts as known to him.

It would appear that while the auditor would be obliged to advise the client that he is doing wrong and should make a clean breast of things with the tax authorities, the auditor himself is not compelled to make any disclosures. If he does so he runs the risk of being sued by the client for defamation, or, if a prosecution is launched, for malicious prosecution in the event the client is found not guilty. Also, the client could perhaps sue him on the grounds that violation of their confidential relationship was a breach of contract.

In any case, an accountant finding himself in this position would have to cease having any further relationship with the client unless the client made a clean breast of things with the tax department. The editorial also advises the auditor to seek the advice of legal counsel as the facts and circumstances of each case may alter his legal responsibilities.

These are good points to be considered from an ethical and moral standpoint.

Obituaries

W. Herbert A. Thompson

The Institute of Chartered Accountants of Alberta announces with regret the death of W. Herbert A. Thompson, F.C.A., of Calgary on October 30.

Mr. Thompson was born and educated in Toronto and moved to Calgary in 1912 where he associated himself with the firm of Edwards, Morgan & Co., Chartered Accountants. He later went into private practice under the name of W. Herbert A. Thompson & Company.

He joined the Alberta Institute in 1913, served as a member of Council from 1914 to 1923 and was president in the year 1917-1918. He was granted a Fellowship in 1952.

Mr. Thompson was a charter member of the Calgary Rotary Club, a prominent member of the Masonic Lodge and was a very active member of the Earl Grey Golf Club.

To his sons and grandchildren the members of the Institute extend their sympathy.

Major Ernest C. Cole

The Institute of Chartered Accountants of Quebec announces with regret the death of Major Ernest C. Cole, C.A., one of its oldest members, on November 27 in Montreal.

Born in Montreal, Major Cole attended the High School of Montreal and the former Lincoln College at Sorel. He was admitted to the Quebec Institute in 1907 and for many years practised his profession. At one time he also served as secretary-treasurer of the Atlas Construction Company.

He was a life member of the Montreal Athletic Association and the Park Tobogganing Club. He was attached to the Second Regiment of the Canadian Artillery.

To his daughter, brothers, and sister the president, council, and members of the Institute extend their deepest sympathy.

Professional Notes

ALBERTA

Mr Ernest Mainwood, C.A. announces the opening of an office for the practice of his profession at 704b 16 Ave. N. W., Calgary.

* * *

Messrs J. L. Kergan, C.A., L. G. Gerla, C.A., and R. C. Berglund, C.A. announce the formation of a partnership and the opening of an office at 818 8 Ave. W., Calgary. Practice of their profession will be conducted under the firm name of Kergan, Gerla & Berglund, Chartered Accountants.

* * *

Morton & Hills, Chartered Accountants, announce the removal of their offices to 321a 7 Ave. W., Calgary.

BRITISH COLUMBIA

Vancouver Island C.A. Club

To close its initial year of activities the Vancouver Island C.A. Club held its first annual general meeting recently and elected the following executive: *president*, John Nation; *secretary-treasurer*, Drummond Taylor; *directors*, Gordon Holms and Robert Middleton; *up-Island rep.*, Archie Clouston. Retiring president Dennis Young reviewed the accomplishments of the past year and discussed plans for the future.

B.C. Institute Fall Meeting

Technical sessions by day and dinner dance in the evening were the highlights of the fall meeting of the B.C. Institute on November 18 at the Hotel Vancouver. The morning session dealt with "Estate Planning", and the afternoon session considered "The Application of the British Columbia Social Security Tax" and "Taxation Problems in Connection with Purchases and Sales of Businesses". Mr. J. Peter Stanley was chairman of the committee in charge.

Special guests in the evening included Mr J. Edwin Eades, president of the Vancouver Bar Association, and Mrs Eades; Mr. J. F. Fox, president of the Certified General Accountants Association, and Mrs Fox; Professor E. D. MacPhee, director of the School of Commerce at the University of British Columbia, and Mrs MacPhee; Mr N. Abramsen, president of the Industrial and Cost Accountants' Society.

MANITOBA

Manitoba Students Society

On November 5 the Manitoba Chartered Accountants' Students Society held a fall dinner and dance in the Fort Garry Hotel, with vice-president Bruce E. Smith presiding at the head table. Among the honoured guests were the chief officers of the Manitoba Institute and their wives.

NOVA SCOTIA

Mr A. Richard Marshall, B.Com., C.A. announces the opening of an office for the practice of his profession at 93 Oakland Rd., Halifax.

ONTARIO

Arthur A. Crawley & Co., Chartered Accountants, announce the admission to partnership of Mr Roy A. Dingle, C.A. He will be a resident partner of their Sudbury office.

* * *

Peat, Marwick, Mitchell & Co., Chartered Accountants, Toronto, announce the removal of their offices to 80 Richmond St. W., Toronto.

* * *

Messrs John E. Howe, C.A., William C. Smiley, C.A., and William A. Lyttle, B.Com., C.A. announce the formation of a partnership for the practice of their profession under the firm name of Howe, Smiley & Lyttle, Chartered Accountants, with offices at 1733 Victoria Ave., Niagara Falls, and at 90A Church St., St. Catharines.

* * *

Magee & Palin, Chartered Accountants, announce the removal of their offices to 2231 Bloor St. W., Toronto.

Ontario Institute

English Visitors, Wednesday, October 27

The president and council of the Institute of Chartered Accountants of Ontario held a reception in the library of the Chartered Accountants Building on Wednesday, October 27, in honour of the presidents of the three chief accountancy bodies in Great Britain, who were visiting Toronto after attending the meetings of the American Institute of Accountants in New York. Sir John Somerville, president of the Institute of Chartered Accountants of Scotland, Mr. D. V. House, president of the Institute of Chartered Accountants in England and Wales, and Mr. W. B. Nelson, president of the Society of Incorporated Accountants, were the guests of honour. The president of the Institute of Chartered Accountants of Ontario and Mrs D. A. Ampleford entertained at dinner for the visitors and their wives.

Ontario Supper Dance and Cabaret

The Ontario Institute held a most enjoyable supper dance and cabaret at the Royal York Hotel on Thursday, November 4. The guests were received by the president and Mrs Ampleford, the vice-presidents and Mrs Brace and Mrs Wilson. A number of dinner parties were held preceding the dance which added greatly to the gaiety of the party. Nearly 500 members and their ladies attended.

Ontario Students Association

A near capacity crowd of about 140 students filled the lecture hall of the Institute building recently to attend a debate on the subject "Resolved that the current trend of labour demands in Canada is unrealistic". The debate was the first in a series of six monthly meetings to be presented by the Ontario Students Association as part of its 1954-55 program. The meetings will take the form of lectures, debates or panel discussions on topics outside of the study course but of general interest. At each meeting students will be encouraged to ask questions from the floor.

Mr Fred Dowling, district director of the United Packinghouse Workers of America, was the labour speaker. Mr Colin Morley, a lawyer associated with the Central Ontario Industrial Relations Institute spoke for management. Mr. Victor Koby, the labour editor of *The Financial Post,* was moderator. After the principal speakers were heard Mr. Dowling answered students' questions for more than an hour.

Future meetings will be held on the second Tuesday of each month at the Institute building, with refreshments being served after the main proceedings are completed.

Kingston C.A. Club

The Chartered Accountants Club of Kingston held a well attended meeting on Friday evening, November 26, at the Kingston Yacht Club. Mr. D. A. Ampleford, F.C.A., the president of the Ontario Institute, and Mr. F. H. Buck, F.C.A., the registrar, were the guest speakers.

Hamilton and District C.A. Association

Chartered Accountants Discuss Depreciation

A panel discussion on the subject "Depreciation: Problems of Determination and Disclosure" was held by the Hamilton and District Chartered Accountants' Association at a dinner meeting at the Wentworth Arms Hotel on December 1.

The discussion dealt principally with the problems arising out of the recent repeal of ITReg 1100(4).

The following members participated on the panel: C. K. MacGillivray, J. G. Brown, E. H. Ambrose, W. C. Chick, and J. M. Thompson. Mr. J. G. Grant, chairman 1954-55, was in charge of the meeting.

PRINCE EDWARD ISLAND

1954 Regional

Conference of Atlantic Institutes

The Institutes of Prince Edward Island and Newfoundland were joint hosts for the 1954 regional conference held in Charlottetown from October 21 to 23.

The program got under way Thursday evening when 35 delegates attended the monthly dinner meeting of the Charlottetown Board of Trade. The speaker at the dinner was J. Harvey Perry, executive director

of the Canadian Tax Foundation. His subject was "Some Reflections on Taxation in the Atlantic Provinces".

J. Grant Glassco, O.B.E., F.C.A., president of the C.I.C.A., was also a special speaker, both at a technical session on "Annual Reports" and on C.I.C.A. affairs.

Other technical sessions on internal control and budgetary control were handled by J. A. Reynolds, C.A. and J. N. MacLeod, M.B.E., C.A., both of St. John's, Newfoundland.

At the luncheon on Friday, the speaker was Dr. George C. Fisher, D.V.M., V.S., a certified instructor of the Dale Carnegie Institute. His subject "We are the Judges" dealt with the relationship of the principal to the employee.

The dinner meeting was followed by a show by Don Messer and his Islanders, and some healthy whoops of approval were heard when the fiddler warmed up.

The final session took the form of a panel discussion on regional Institute affairs led by the Institute presidents. The topics included education and examinations, reciprocity in transfers of members and students, liaison among the Atlantic Institutes through a committee of presidents, Atlantic representation in Canadian Institute affairs.

QUEBEC

McDonald, Currie & Co., Chartered Accountants, announce the opening of an office for the practice of their profession at Rue St. Jean, Rimouski. Mr Gerard Lachapelle, C.A. will be resident manager.

* * *

Mr George Berlind, B.Com., C.A. announces the removal of his offices to Ste. 9, 1022 Sherbrooke St. W., Montreal, Que.

SASKATCHEWAN

Goldie, Hunt & Co., Chartered Accountants, announce the removal of their offices to 503 Sterling Trust Bldg., Regina.

* * *

McMillan & Dill, Chartered Accountants, 236 Second Ave. S., Saskatoon, announce the admission to partnership of Mr J. A. MacDonald, C.A.

News of Our Members

Mr Jack Plumpton, C.A. (Ont., Que.), has been appointed secretary-treasurer and comptroller of National Steel Car Corp. Ltd., Hamilton.

* * *

Harrison & Co. Ltd., Toronto, announces the appointment of Mr W. F. Hills, C.A. (Ont.), as assistant secretary-treasurer and office manager.

* * *

Mr W. W. B. Dick, C.A. (N.B., N.S., P.E.I.), director of the accounting institute sponsored by the Maritime Hospital Association, presided at a five-day meeting of Maritime hospital accountants and administrators at the end of November. Speakers at the meeting included James O. Borlase, C.A. (Que., N.B.), and George H. Steeves, C.A. (N.B.).

* * *

Mr E. M. Gunderson, C.A. (Alta., B.C., Man.), special trade representative for the Government of British Columbia, was guest speaker at a luncheon held in London, England, under the auspices of the Canadian Chamber of Commerce in Great Britain.

* * *

Mr Walter J. Macdonald, F.C.A. (Man.), past president of the C.I.C.A., was one of the guest speakers at the 24th annual convention of the Manitoba Chambers of Commerce.

The Students' Department

• J. E. Smyth, C.A., Editor

(Correspondence with the editor is cordially invited.)

NOTES AND COMMENTS

WE are pleased to draw attention in this issue to some brief notes, below, on a most elusive yet important topic: the theory of income measurement. We wish to thank the reader who was good enough to prepare these notes, and commend his thoughtful analysis to other readers.

* * * *

By the time these *notes* appear the results of the fall examinations will have been announced. We should therefore like to be among those to offer congratulations to the successful candidates, and to wish them a happy future.

* * * *

In commenting on the solutions presented by candidates for Problem 2 of the problems and solutions appearing in this issue, the examiner has noted that a number of candidates spent a great deal of time preparing journal entries, work sheets, and trial balances. Clearly here is a point at which a candidate's *procedure* in attempting a solution is quite as important as his *knowledge* of the subject-matter.

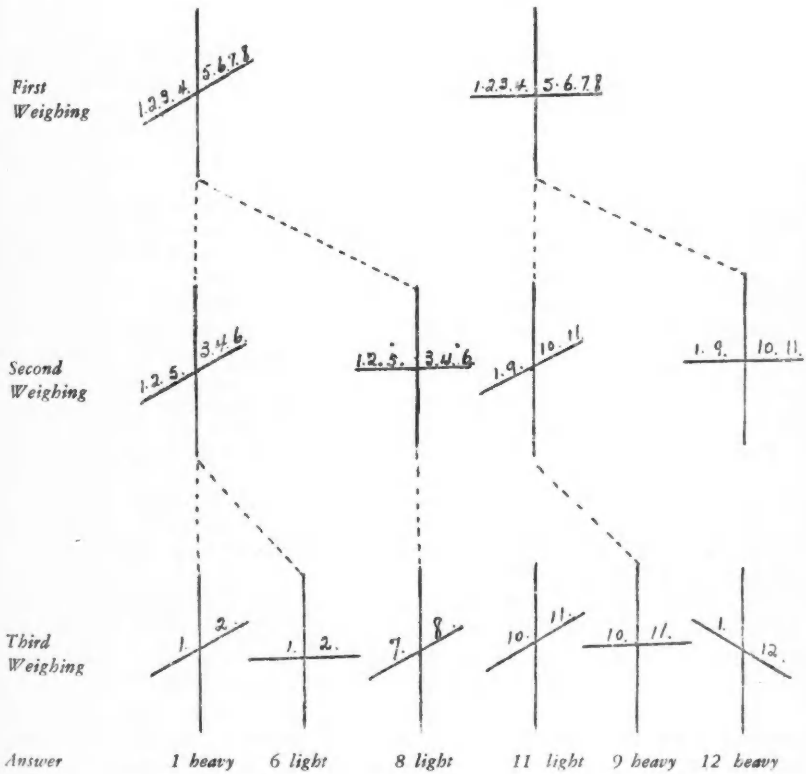
The problem is one requiring the preparation of a combined income statement for head office and an Australian branch, in Canadian dollars. We must confess to a temptation to do just what apparently many candidates did do when confronted with such a problem — we like to feel our way around the problem by doing some things not required directly in it and by this method to get a grip on the problem. Yet we know perfectly well that precious time can be wasted in the process; we may even, for example, prepare trial balances not required . . . and then what are the depths of our despair if they do not balance! The problem in this case required the preparation of an income statement. Why not, then, proceed directly with the preparation of the income statement, and deal with the problems one by one as they arise instead of trying to anticipate them? When one follows this procedure at least everything he does will be counting towards the marks available for the solution.

We suppose, however, that this difficulty points up a difference between examination technique and what is generally required in actual accounting practice; a difference which, from the point of view of examination candidates, we think it is important to recognize. In practice the student-in-accounts is expected to produce a nice set of working papers with the final results documented by supporting schedules, work sheets, and trial balances, and the whole carefully indexed

and cross-referenced. On an examination the student is still supposed to write legibly and to use proper headings for his work, but the shortest method of satisfying the requirements of the problem (and no more) is the best one.

SOLUTION TO LAST MONTH'S PUZZLE

(To follow solution, balls are numbered 1 to 12)



PUZZLE

A six-digit number has "1" for the last digit. If this last digit is removed and placed before the others, a new six-digit number is formed whose value is one-third that of the original number. What is the original number?

(Submitted by Mr. S. B. Bentley, Regina, Saskatchewan.)

NOTES ON THE THEORY OF INCOME MEASUREMENT

(Prepared by Mr. R. C. Kingsley, Vancouver, B.C.)

Business income is computed as the difference between opening and closing net assets, in so far as that difference is the result of the ordinary transactions of the business in dealing with people *at arm's length.*

From this the following classification may be deduced:—

Included in the calculation of income

1. External sales
2. Purchase of goods and services which are consumed or disposed of (e.g. the value obtained from the use of fixed assets, merchandise sold, supplies used up, salaries, etc.)
3. The amount by which the proceeds of disposal of fixed assets exceeds or falls short of the dollar amount assigned to these assets on the books.
4. The amount by which the proceeds of disposal of investments exceeds or falls short of the dollar amount of these assets on the books.

Excluded from the calculation of income

1. Partners' drawings (within arm's length)
2. Dividends (within arm's length)
3. Introduction of new capital (within arm's length).
4. Obtaining or repaying loans (no change in net assets except for interest charges)
5. Sales within arm's length (Partners' consumption of goods off the shelves is considered as drawings and charged out at cost.)
6. Purchase of goods or services not consumed or disposed of (e.g., closing inventory of stock, supplies on hand, the cost of unused services of fixed assets) — no change in net assets.
7. Withdrawal of capital investment (within arm's length).
8. Sale of fixed assets (or investments) at exactly the dollar amount assigned to them on the books (a mere exchange of assets resulting in no change in net assets).

We are on thin ice when we include sales to shareholders in the calculation of income but exclude sales to partners, on the grounds that the latter sales, only, are within arm's length.

For if we say that a shareholder, having a separate existence from the company, is dealing at arm's length when he purchases goods as a customer, we are going to bring down on our heads the argument that the payment of dividends should be expense, since it, too, is a transaction with shareholders.

If we say that the shareholder is acting as owner (within arm's length) in receiving a dividend, but as customer (at arm's length) in making a purchase, we will have to admit that the partner withdrawing goods for his own use is dealing at arm's length .

But, after all, it could scarcely be regarded as conservative to treat a partner's withdrawal of goods for his own use as being at arm's length . . . . We must thank Professor Paton for getting us out of a nasty corner — "When an accountant has no real argument to advance, that's always his last word: 'It isn't conservative'."

Editor's Note: The above exposition stimulates us to offer a further point, for what it is worth. We suggest that when we say that a sale to a shareholder should be considered to be at arm's length whereas dividends are not, we are really assuming that the company in question has many shareholders and that the shareholder to whom the sale

is made does not hold a large proportion of the shares. The sales transaction is then with a person who is acting alone and is unable to influence the terms of the sales contract any more than any other customer. On the other hand, the declaration of a dividend is a transaction involving shareholders *as a group*: and, acting in concert, it may be possible for shareholders to influence dividend policy through the election of the directors.

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner, but rather to provide such discussion and explanation of the problems as will make their study beneficial. The editor will welcome discussion of the solutions published.

PROBLEM 1

Intermediate Examination, October 1953

Accounting II, Question 5 (25 marks)

Two brothers, JB and KB, formed a partnership on 1 Jan 1952 to acquire a business. The following assets were acquired:

Inventory	$9,700
Land	1,200
Building	4,800
Truck	2,500
Equipment	2,800

On 1 Jan 1952 JB put $20,000 and KB $10,000 into the partnership bank account and issued a cheque for $2,000 on account of the purchase price of the assets acquired and entered into an agreement for the balance.

The partners agreed that:

(a) JB should receive a salary of $400 per month, KB $300 per month.

(b) JB should receive 2% interest on the excess of his investment over KB as at the end of each year before profits are distributed or drawings for the year are considered.

(c) Profits, after taking the foregoing into consideration, should be shared equally.

The following is the trial balance of B Bros. as at 31st December 1952:

B BROS.

TRIAL BALANCE

as at 31st December 1952

	Dr.	Cr.
Cash	$ 450	
Bank	4,000	
Accounts receivable	4,000	
Dues and donations	250	
Repairs and maintenance	680	
Insurance	500	
Postage and stationery	210	
Memberships	200	
Salaries and Wages — Employees	9,000	
— JB	4,800	
— KB	3,600	

Sales		$127,500
Accounts payable		2,900
Freight in	2,500	
Unemployment insurance	110	
Truck expense	1,500	
Taxes and licences	450	
Light, heat and water	850	
Purchases	107,050	
Purchase discounts		1,200
Capital — KB		10,000
— JB		20,000
Telephone, telegraph	200	
Land	1,200	
Building	4,800	
Truck	2,500	
Equipment	2,800	
Inventory	9,700	
Advertising	250	
	$161,600	$161,600

The inventory as at 31 Dec 1952 was valued at $16,300. Depreciation is to be calculated at 5% per annum for the building, 30% per annum for the truck and 15% per annum for the equipment.

Required:

(5 marks) (a) The journal entries which should have been made to set up the partnership accounts and to record the acquisition of the assets by the partnership.

(17 marks) (b) Statement of profit and loss of B Bros. for the year ended 31 Dec 1952.

(3 marks) (c) Statement showing your computation of the balance as at 31 Dec 1952 in the capital accounts of JB and KB.

A SOLUTION

BOOKS OF B BROS.

		Dr.	Cr.
1952			
Jan. 1	Bank	30,000	
	Capital — JB		20,000
	Capital — KB		10,000
	To record initial investment by JB and KB		
Jan. 1	Inventory	9,700	
	Land	1,200	
	Building	4,800	
	Truck	2,500	
	Equipment	2,800	
	Bank		2,000
	Note payable		19,000
	To record acquisition of assets by the partnership		

B BROS.

STATEMENT OF PROFIT AND LOSS

for the year ended 31 Dec 1952

Sales			$127,500
Deduct cost of goods sold			
Inventory 1 Jan 1952		$ 9,700	
Purchases	$107,050		
Less purchase discounts	1,200		
	105,850		
Add freight in	2,500		
		108,350	
		118,050	
Less inventory 31 Dec. 1952		16,300	
			101,750
Gross trading margin			25,750
Deduct selling and administrative expenses			
Salaries and wages		9,000	
Depreciation of building		240	
Truck expense		1,500	
Light, heat and water		850	
Depreciation of truck		750	
Repairs and mtaintenance		680	
Insurance		500	
Taxes and licenses		450	
Depreciation of equipment		420	
Dues and donations		250	
Advertising		250	
Postage and stationery		210	
Memberships		200	
Telephone and telegraph		200	
Unemployment insurance		110	
			15,610
Net margin before partners' salaries and interest on capital			10,140
Deduct partners' salaries and interest on capital			
Salary — J.B		4,800	
Salary — KB		3,600	
Interest on capital — J.B.		200	
			8,600
Profit for year			$ 1,540

B BROS.

STATEMENT OF PARTNERS' CAPITAL ACCOUNTS

for the year ended 31 Dec 1952

	JB	KB	Total
Initial cash investment 1 Jan 1952	$20,000	$10,000	$30,000
Interest allowed on capital — JB	200		200
Share of profit (after salary payments to partners)	770	770	1,540
Balances 31 Dec 1952	$20,970	$10,770	$31,740

Editor's Notes

1. The deduction of purchase discounts from merchandise purchase cost assumes that the discounts were obtained on purchases of merchandise only. This may not always be the case and accordingly purchase discounts are often treated instead as an item of subsidiary revenue after net margin.
2. In the editor's opinion the partners' salaries and interest on capital might alternatively have been excluded from the income statement and treated as credits to the partners in their capital accounts; since the salaries are paid, they should then also have to be charged to the capital accounts as drawings.

PROBLEM 2

Final Examination, October 1953

Accounting III, Question 4 (20 marks)

The E Co. Ltd., a Canadian manufacturing concern, decided to establish a branch office in Sydney, Australia, to handle sales in that country.

The following is the head office trial balance as at 30 June 1953:

	Dr.	Cr.
Current assets	$ 210,000	
Machinery and equipment	1,000,000	
Buildings	750,000	
Branch account	2,992,500	
Current liabilities		$ 105,000
Accumulated depreciation		600,000
Capital stock		3,000,000
Surplus		717,500
Sales		5,000,000
Purchases	6,500,000	
Shipments to branch		2,310,000
Expenses	130,000	
Inventory 30th June 1952	150,000	
	$11,732,500	$11,732,500

The balance in the branch account is the result of the following transactions:

(a) 1 July 1952
Cash advanced to branch on opening of branch $189,000.

(b) 1 Sept. 1952
E Co. Ltd. shipped to branch equipment which had cost $297,000 and against

which depreciation of $88,500 had been accumulated on the head office books. Original cost is recorded on the branch books with related accumulated depreciation at the date of transfer.

(c) Merchandise shipped to branch during the year was charged out to the branch at 110% of cost.

(d) Shipping charges thereon amounting to $560,000 were prepaid by head office.

(e) On 1st April 1953 the branch remitted to head office $275,000.

Other transactions reflected on the branch books for the year ended 30 June 1953 were:

(a) On 1 August 1952 a down payment of £22,000 was made by the representative on the purchase of a building, the full purchase price being £66,000.

(b) Furniture and fixtures were purchased at a cost of £10,000 in cash on 15th August 1952.

(c) Australian branch made additional merchandise purchase in Australia during the year amounting to £400,000.

(d) Total sales made by Australian branch during 1952-53 amounted to £1,400,000.

(e) Australian branch paid expenses during the year amounting to £40,000.

(f) During the year the Australian branch made a further payment on the building of £20,000.

Depreciation is to be calculated at 5% on buildings and 10% on furniture and fixtures and on machinery on a straight line basis on the closing balances of the asset accounts.

Inventories as at 30 June 1953 were:

Head office	$125,000
Branch merchandise from head office	£ 30,000
Merchandise purchased in Australia	£ 75,000

For purposes of this problem the rate of exchange is to be taken as follows:

1st July	1952	£1 worth	$2.70
1st August	1952	"	2.71
15th August	1952	"	2.65
1st September	1952	"	2.64
1st April	1953	"	2.75
30th June	1953	"	2.80

Average for period 1st July 1952 — 30th June 1953 —
£1 worth $2.65

For the purposes of this question, taxes on income are to be ignored.

Required:

Prepare a statement of profit and loss of the branch and of the combined head office and branch operations for the year ended 30 June 1953 indicating the bases used for converting the branch profit and loss items from Australian to Canadian funds.

(For solution see page 50)

A SOLUTION TO FINAL ACCOUNTING III (QUESTION 4)

THE E CO. LTD.

Statement of Branch and Combined Operations for the Year Ended 30 June 1953

	Conversion rate used	Australian Branch		Head Office		Combined	
Sales	$2.65		$3,710,000		$5,000,000		$8,710,000
Deduct cost of goods sold							
Inventory 30 Jun 1952		—		$ 150,000		$ 150,000	
Purchases	2.65	$1,060,000		6,500,000		7,560,000	
Shipped by head office to branch	actual	2,310,000		(2,100,000)		—	
Shipping charges	actual	560,000				560,000	
		3,930,000		4,550,000		8,270,000	
Less inventory 30 Jun 1953				125,000		125,000	
from head office	2.80	84,000				76,363	
from Australian sources	2.80	210,000				210,000	
		294,000		125,000		411,363	
Cost of goods sold			3,636,000		4,425,000		7,858,637
Gross trading margin			74,000		575,000		851,363
Deduct trading expenses							
General expenses	2.65	106,000		130,000		236,000	
Depreciation							
— buildings	2.71	8,943		37,500		46,443	
— furniture and fixtures	2.65	2,650		—		2,650	
— equipment	2.64	29,700		100,000		129,700	
			147,293		267,500		414,793
					307,500		
Add profit on shipments to branch					210,000		
					517,500		
Deduct profit included in branch inventory					7,637		
Profit (loss)			($73,293)		$ 509,863		$ 436,570

Examiner's Comments

A number of candidates spent a great deal of time preparing journal entries, work sheets, and trial balances.

The common errors were:

1. Calculation of depreciation on equipment purchased from head office was based on net book value.
2. Shipping charges were omitted entirely in many cases. In some cases shipping charges were not shown in Branch profit and loss but were included in the combined statement; in other cases they were not included in cost of sales but were shown as an expense.
3. Calculation of a profit on conversion of Branch account was attempted.
4. The mark-up on shipments from head office and inventory was deleted in the branch profit and loss.

Presentation of the branch profit and loss in pounds sterling was accepted.

PROBLEM 3

Final Examination, October 1953

Auditing II, Question 4 (21 marks)

(3 marks for each part)

The following questions form part of the internal control questionnaire regarding a merchandising concern:

(a) Are deposit or collection items which are charged back by the bank as uncollectible delivered directly to an employee other than the person directly responsible for making up the deposit?

(b) Are signed cheques handled by an employee whose duties do not include:
  (i) posting accounting records,
  (ii) recording cash receipts,
  (iii) handling petty cash funds, and
  (iv) approving vouchers for payment?

(c) Do responsible officials of the company periodically undertake to request customers to confirm unpaid balances of notes receivable?

(d) Is approval of a responsible official a prerequisite to payment of customer credit balances?

(e) Are securities which have been written off or for which a full allowance has been provided followed up as to possible realizability?

(f) Are adjustments of recorded accounts payable required to be approved by a properly designated person?

(g) Are sales invoices summarized and classified by a department other than the accounting department in a manner to provide a check on recorded sales?

Required:

In respect of each of the foregoing questions, what weaknesses in the system of internal control are disclosed by a negative answer, and what errors or defalcations would be facilitated by such weaknesses?

A SOLUTION

(a) A negative answer would indicate insufficient division of labour. The person making up a deposit should not have access to the accounts receivable records and each person's work should be checked independently. If the practice is to deliver returned items to the person making deposits, he would be able to "kite" over the end of the year by including uncollectible items in the year-end deposit. The practice might also

permit the employee to misappropriate money received in payment of a customer's note by representing the note as a returned item and writing it off as uncollectible.

(b) A negative answer would indicate insufficient division of labour. Defalcations involving the issue of cheques require the preparation and passing of fictitious vouchers or improper entries in the books to correspond with the cheques. By divorcing the mailing of cheques from persons who have access to the means required to cover up improper payments, the likelihood of such defalcation is materially decreased. This division of labour should apply to the disposition of all cheques issued.

(c) A negative answer would disclose a lack of independent check on employees. A misappropriation of money paid by customers in settlement of notes can be covered up by showing the notes as being in arrears or paid late unless an independent verification of the unpaid balances is made periodically.

(d) A negative answer would indicate that not all disbursements are made on properly authorized requisitions. Unless independent approval is secured, money provided for the payment of old credit balance might be misappropriated. Fictitious credit balances might even be established with a view to issuing cheques against them at some future time. An independent official should satisfy himself as to the reason for the credit balance and approve its payment in all cases.

(e) A negative answer would indicate lack of adequate control of assets. Any assets for which there is a possibility of future realization should be recorded in such a way on the accounts that their values will come up for fresh consideration at regular intervals. Investments should at most be written down to $1.00 rather than written off completely, so that their existence cannot be overlooked. Otherwise if such assets should become valuable they might be misappropriated without the defalcation requiring any entries or covering up.

(f) A negative answer would indicate that not all disbursements are made on properly authorized requisitions. If adjustments of recorded accounts payable are not independently approved, the approval of the original vouchers is defeated; alterations can take the place of improper vouchers in a defalcation program.

(g) A failure to undertake this work is not a weakness in the system of internal control, so much as the absence of an additional check. By having sales independently summarized by another department, and presumably having the totals cross-checked, the possibility of falsifying the sales summary is overcome for all practical purposes.

THE TAX REVIEW

By Melville Pierce, B.A., LL.B., Barrister-at-Law

[1955] JANUARY Part I

RECENT TAX CASES

Minister of National Revenue v. Anaconda American Brass Ltd.

(Supreme Court of Canada, Kerwin C.J.C., Taschereau, Estey, Locke and Cartwright JJ., November 1, 1954)

Business Profits — Computation of — Ascertaining cost of goods sold — Last-in-first-out basis of valuing inventory — Whether admissible — IWTA (1947)

Since its incorporation in 1922 appellant company operated a primary mill wherein it produced copper and copper alloys in the form of sheets, rods and tubes, which it sold to its customers for further manufacture by them. It purchased practically all of its metal supplies from Canadian refineries, and made its profit solely by processing them: it did not trade or speculate in metals. The company's practice was to base its selling prices on the replacement cost of the metal content plus a processing charge and an allowance for profit, and accordingly it altered its selling prices in accordance with fluctuations in metal prices and matched its purchases of metals as closely as possible to its sales of finished products. It made no attempt to use metal in the order of its purchase or in any particular order, and once metal went into process its identity became lost. The rate of turn-over of metal was slow, *viz* three or four times a year. At the end of each of the company's fiscal years the cost of the metal sold in the year was calculated on the assumption that the latest metal purchased was the first processed (the LIFO method). The company had calculated the cost of its inventories of metal by this method since 1936, although only for its own purposes, and it was not until 1947 that it employed the LIFO method in calculating the cost of its metal for income tax purposes, and it did so in that year largely with a view to reducing the amount of its tax liability. The Minister rejected the LIFO method in assessing appellant company's profits for 1947 and substituted the first-in-first-out (FIFO) method of calculating the cost of its inventory of metal. The cost of metal sold during 1947, calculated by the FIFO method, was shown at $1,611,756 less than by the LIFO method and the company's profits for the year increased by the same amount. The company appealed to the Exchequer Court of Canada, where Thorson P. allowed its appeal

[1952] Tax Rev. 171. The Minister thereupon appealed to the Supreme Court of Canada.

Held (*per* Taschereau, Locke and Cartwright JJ.), the Minister's appeal must be rejected.

Per Locke J.: The point to be determined is as to what is the method of inventory accounting which will most accurately determine the company's income for the year in question. The evidence established that the cost of the metal content of goods sold could not be calculated with exactness on the basis of the actual physical flow of inventory, that under 1947 conditions purchases of raw material could not be hedged, and that owing to price fluctuations in that year the calculation of such cost was not exact. In the absence of any statutory rule for the calculation of the cost of inventory it must be determined upon the ordinary principles of commercial trading, and on the evidence here the LIFO method determined the company's true income more accurately than any other method which it was practical to apply.

Per Cartwright J.: I concur with the reasons and conclusion of Thorson P. in the Exchequer Court. The only questions of difficulty are questions of fact, the rule of law being that the true gains are to be ascertained as nearly as it can be done: per Loreburn L.C. in *Sun Ins. Office* v. *Clark* [1912] A.C. 443 at p. 454. Here the evidence fully supports the learned President's finding of fact that the LIFO method furnished a more accurate figure for cost of materials sold than the FIFO method. In a year in which the prices of the company's metals rise or fall the LIFO method will show the true gain for the year as nearly accurately as is possible while the FIFO method will show a fictitious profit or loss, as the case may be.

Per Taschereau J.: For the the reasons given by Locke and Cartwright JJ. I would dismiss the appeal.

Per Kerwin C.J.C., dissenting: The assumption on which the LIFO method is based, namely that the inventories last acquired were those first sold, was contrary to the actual facts as shown by the evidence, and the fact that LIFO was an acceptable method for corporate accounting purposes was not sufficient to permit its employment for taxation purposes. The FIFO method determined the company's true income for 1947 more accurately than did the LIFO method. *Whimster* v. *C.I.R.*, 12 T.C. 813, per Lord Clyde at p. 823; *Patrick* v. *Broadstone Mills Ltd.* [1954] 1 A.E.R. 163; *Ryan* v. *Asia Mill Ltd.*, 32 T.C. 275 (H.L.); *Sun Ins. Office* v. *Clark, supra,* discussed.

Per Estey J., dissenting: While some arbitrary assumption as to the flow of inventories was necessary in the circumstances, the problem which must be decided for taxation purposes as between the FIFO and LIFO assumptions is which of the two more nearly furnishes the actual value or market value of the inventory on hand. *In re Spanish Prospecting Co.* [1911] 1 Ch. 92 per Fletcher Moulton L.J. at p. 98 and 100, applied.

Minister's appeal dismissed

Articles and cases in *The Tax Review* are cited by reference to the year and Part in which the case or article appears. Two Parts will be published each year: Part I comprises the issues of *The Canadian Chartered Accountant* from January to June, and Part II the issues from July to December.

INCOME TAX APPEAL BOARD CASES

Fabio Monet, Esq., Q.C. (Chairman), Cecil L. Snyder, Esq., Q.C. (Assistant Chairman), W. S. Fisher, Esq., Q.C. and R. S. W. Fordham, Esq., Q.C.

Duchaine v. M.N.R.

Business Expenses — Deductibility of — Ship's pilot — Meals and taxis — No necessity for — Capital cost allowances on suitcases — Not allowable

Duchaine was a licensed ship's pilot resident in Quebec City who earned fees of nearly $8,000 in 1951, against which he claimed deductions of $1,724 in reporting his income for tax purposes, in particular (a) $330 for meals and lodging at a hotel in Father's Point where he stayed when his duties took him there; (b) $540 for 240 meals at $2.25 each in Quebec City while awaiting assignment to a ship after being advised that his services would likely be required in the near future; (c) $275 for taxi fare from his home to the harbour and vice versa in connection with his duties, of which the Minister would allow only $170; (d) $90 for tips voluntarily paid by him to apprentice pilots; (e) $50 capital cost allowances on two suit cases used to carry his personal effects on his trips.

Held (Mr. Monet), the $330 for meals and lodging at Father's Point was an allowable expense, but none of the other items was allowable. The evidence established that Duchaine was under no necessity of paying for meals rather than having them at home while awaiting assignment to a ship, and that there was no necessity of him hiring a taxi to take him from his home to the harbour and vice versa, and that he used taxis solely for greater comfort and convenience. Neither was he under any obligation to pay anything to apprentice pilots. Capital cost allowances were not claimable on his suitcases since the evidence did not show that either or both suitcases were acquired for the purpose of enabling him to earn income from his calling as they could be used for other purposes as well.

Que, Aug 12/54 *Allowed in part*

Wald v. M.N.R.
Jensen v. M.N.R.
Ferbey v. M.N.R.

Business Expenses — Professional Entertainers — Personal as distinct from business expenses — Necessity for expenses

The three appellants were professional musicians, known as the "Rhythm Pals" who in 1951 broadcasted one hour a day for six days a week under a contract with a broadcasting company and (apparently) performed elsewhere as well. In computing their income for tax purposes for that year each of them claimed certain deductions which were disallowed on assessment. They appealed.

Held (Mr. Fordham), on the evidence appellants performed contracts for services rather than contracts for service in 1951 notwithstanding their contract with the broacasting company, and they were therefore entitled to deductions in respect of the following items disallowed by the assessor: the cost of audition discs, of meals away from the city of their residence, and of car expenses and capital cost allowances adequately proved. No deduction was, however, allowable for the cost of a private as distinct from a business telephone, for the cost of cleaning costumes, which was a personal expense, and the cost of sheet music and records was allowable only by way of capital cost allowances. The cost of boots and shirts and special costumes purchased for their work was also a personal expense since these items could be

worn on other occasions also, even a "cowboy garb of unusual hue", for if it was true that it could not be worn on other occasions it was a costume voluntarily adopted by the trio and could hardly be termed essential, however desirable from a performer's standpoint: *94* v. *M.N.R.* 53 D.T.C. 157; 8 TABC 208 (Mr. Monet) followed.

B.C. May 20/54 *Allowed in part*

Editor's Note: That sheet music and records should be regarded as capital assets, i.e. as possessing enduring utility in the same way as plant and machinery, though not easy to accept, is perhaps of no great monetary significance; it is equally difficult to understand why a costume purchased by a professional entertainer for purely professional purposes should be regarded as a personal rather than a professional expense. Most important of all, however, one may hope that in putting as a criterion of deductibility the Court's opinion of an expense's necessity from a business point of view, this decision was pronounced *per incuriam.* Upon occasion even Homer nodded.

195 v. M.N.R.

Business Expenses — Trading company — Solicitors' fees of successfully contesting income tax assessments — Not a business expense — ITA (1951)

Appellant, a corporation in the lumber business, incurred solicitors' fees of nearly $8,000 which it paid in 1951 for services rendered by its solicitors in contesting income tax assessments raised against the company by a western Province and by the Dominion for the years 1937 to 1945. Appeals against the assessments were launched but in all cases the assessments were reduced following representations made by the solicitors to the government officials concerned.

Held (Mr. Fordham), the solicitors' fees were not laid out for the purpose of earning the company's income from its trade but were applications of its income after it had been earned: *Smith's Potato Estates Ltd.* v. *Bolland* (1948) 30 T.C. 267 (H.L.) followed.

Sep 24/54 *Dismissed*

Editor's Note: As the Supreme Court of Canada held in *Dom. Natural Gas Co.* v. *M.N.R.* [1941] S.C.R. 19 and again in *Kellogg Co.* v. *M.N.R.* [1943] C.T.C. 1, "in the ordinary course legal expenses are simply current expenditures and deductible as such". In this case it is not disputed that the solicitors' fees for contesting the tax assessments are current expenditures, but the decision of the House of Lords in *Smith's Potato Estates Ltd.* v. *Bolland* is relied on for another ground of disallowance, *viz* that the expense in question is not a business expense at all, but rather an expenditure made by the company in its quality as a taxpayer.

Griffith v. M.N.R.

Business Expenses — Convention expenses of practising doctor — Not laid out to earn professional income — ITA s. 12(1)(a)

Griffith, a leading anaesthetist in Montreal, who engaged in practice, was on the staff of several hospitals, and on the teaching staff of a university, spent $2,170 in 1951 for transportation, meals and lodging while attending meetings of the International Anaesthesia Research Society of which he was chairman, a meeting of the Council of the Canadian Anaesthetists Society of which he was a member, and other medical association meetings where he delivered addresses at Cleveland, Toronto, Murray Bay, New York, London, Oxford, Liverpool, Edinburgh, and Paris.

Held (Mr. Monet), notwithstanding that his attendance at these conventions kept appellant's name before the medical profession and in that way contributed towards the earning of his income, it could not be said that the expense of attendance at Board meetings and medical conventions was incurred for the purpose of gaining or producing income

from his profession within the meaning of ITA s. 12(1)(a), and such expense was therefore not deductible.

Que, Sept 30/54 *Dismissed*

Huffman v. M.N.R.

Property sold for fixed price payable out of production — Not a "rent, royalty, annuity or other like periodical receipt" — IWTA s. 3(1)(j) — An amount dependent on production of property — ITA 1948 s. 6(j)

Huffman, who was in the stage line and taxi business in northern British Columbia, purchased 48 placer mining leases in that area in 1942, and by contract executed in August 1945 sold 5 of such placer leases to one L for $25,000 to be paid by delivering to Huffman 25% of all gold obtained from the leases within 30 days after its removal until the full purchase price was paid, together with interest thereon at 2½% per annum. Pursuant to such contract the purchaser paid Huffman $2,000 in 1946, $2,000 in 1947, $2,500 in 1948 and $3,000 in 1949. Huffman was assessed to income tax in respect of the above amounts for the years mentioned, the Minister relying on IWTA s. 3(1)(f) for the years 1946 to 1948 and on ITA 1948 s. 6(j) for 1949. Under IWTA s. 3(1)(f) the following was declared to be "income" within the meaning of the Act:

> rents, royalties, annuities or other like periodical receipts which depend upon the production or use of any real or personal property, notwithstanding that the same are payable on account of the use or sale of any such property.

Under ITA 1948 s. 6(j) the following is required to be included in computing the income of a taxpayer for a taxation year:

> amounts received by the taxpayer in the year that were dependent upon use of or production from property whether or not they were instalments of the sale price of the property, but instalments of the sale price of agricultural land shall not be included by virtue of this paragraph.

Held (Mr. Fisher), for the years 1946, 1947 and 1948 only the portion of the payments attributable to interest on the unpaid purchase-price was chargeable to tax, but for 1949 the entire payment was chargeable. The sums received in 1946, 1947 and 1948 were not "rents, royalties, annuities or other like periodical receipts" within the meaning of that phrase in IWTA s. 3(1)(f): *Jones* v. *C.I.R.* [1920] 1 K.B. 711 per Rowlatt J. at p. 714, applied. The payment made in 1949 was, however, within the meaning of that phrase in ITA s. 6(j): "amounts received by the taxpayer in the year that were dependent upon use of or production from property whether or not they were instalments of the sale price of the property". The words "such amounts" are broader than the words "rents, royalties, annuities or other like periodical receipts" in the former provision.

B.C., Aug 12/54 *Allowed in part*

Russell v. M.N.R.

Personal Corporation — Property received from one shareholder — Non-arms length sale — Capital cost allowances — ITAmdt Act 1949 (II), c. 25, s. 8(3) — Whether retrospective in effect — ITA s. 61(3) and *(4)*

In 1944 Russell was one of the three incorporators of the H. Co. and a week after its incorporation he sold it a certain building for $40,000, and that was the only property the company ever acquired. At a later date Russell held 49 shares of the company's stock, and his father-in-law held 50 shares, of which he gave 44 to his daughter, (Russell's wife) and sold 4 shares to Russell. In 1950 capital cost allowance of $2,388 was claimed in respect of the property sold to the company, which was a per-

sonal corporation for taxation purposes. The Minister, however, invoked s. 8(3) of the *Income Tax Amendment Act (2nd Sess.)*, c. 25 and would allow capital cost allowance calculated not on the cost of the building to the company but only on its cost to Russell, which was lower. Since the company was a personal corporation this lower allowance was reflected in Russell's personal income tax liability, and he appealed.

Held (Mr. Fordham), section 8(3) of the *Income Tax Amendment Act 1949 (2nd Sess.)*, c. 25 applied, and the appeal must be dismissed. The application of the 1949 enactment was not displaced by ITA s. 61(4) respecting the valuation to be placed on property transferred to a personal corporation, since s. 61(4) related to a different matter. Neither could it be said that to apply s. 8(3) of the 1949 statute would be to give it retroactive effect, which could not be done in the absence of specific language to that effect. Finally the Minister was right in attributing all of the company's income to Russell even though his wife held a substantial number of shares. Under ITA s. 61(3) the income of a personal corporation is attributed to the shareholders from whom, or from whose predecessors in title, the company received its property.

B.C., Aug 16/54 *Dismissed*

Copp v. M.N.R.

Indirect Payment — Controlling shareholder of personal corporation — Directing company to make gift to relative — Undistributed income on hand — ITA s. 16(1)

Appellant and her daughter Elsie were the sole and equal shareholders and the sole directors of a company which had accumulated $16,138 undistributed income as an operating company up to December 31, 1950. Beginning on January 1, 1951 the company became a personal corporation. In 1951 the company had income of $1,210, the whole of which was charged to income tax in appellant's hands in that year under the provisions of the Act relating to personal corporations. None of that amount was actually withdrawn from the company's possession, however. In the same year, with the assent of appellant and her daughter Elsie, the company made a gift of $4,000 to another daughter of appellant and a gift of $1,000 to a son-in-law. The Minister assessed appellant to income tax in respect of the gifts, $5,000, less the amount on which appellant had paid income tax in that year, $1,210, *viz* $3,790.

Held (Mr. Fordham), appellant was properly chargeable to income tax on the said amount under ITA s. 16(1), which provides that a payment made pursuant to the direction of or with the concurrence of a taxpayer to some other person for the benefit of the taxpayer or as a benefit that the taxpayer desired to have conferred on the other shall be chargeable to the taxpayer to the extent that it would be if the payment had been made to him. If appellant's share of the undistributed income of the company were paid to her it would be taxable in her hands, and by directing or arranging for the company to pay to others instead of to herself moneys that were virtually her property she could not avoid the impact of s. 16(1).

B.C., Aug 6/54 *Dismissed*

186 v. M.N.R.

Expenses — Deductibility of — Expense of maintaining property held for revenue — No income actually derived from property — ITA (1950) s. 12 (1)(a)

In 1949 appellant in partnership with a solicitor leased a vacant building with an option to purchase it, their object

being to open a cocktail bar therein. In pursuance of this object the partners procured the incorporation of a company, their intention being that the company should obtain a licence to operate a cocktail lounge, make the necessary alterations to the building for that purpose, and lease the building from the partners. The company's first application for a cocktail lounge licence was rejected by the provincial liquor Board, but the company proceeded with its plans for converting the building, employed an architect and obtained a building permit. The building remained vacant throughout, and the partners, desiring to reduce their costs, exercised their option to purchase it. A second application by the company for a cocktail licence was rejected by the Board, and the partners decided to carry on and make another application at the next meeting of the Board. Prior to the next meeting of the Board, however, they received an offer to purchase the building which they accepted, and accordingly sold the building in 1950. In that year appellant paid the following expenses in respect of the building: realty taxes, interest on mortgage, insurance, repairs and maintenance, hydro and water, totalling $12,359, and he claimed a deduction of this amount in reporting his income for 1950.

Held (Mr. Monet), the partners acquired the building and held it with a view to leasing it to a company, another entity, and deriving rental income therefrom, and the expenses in question were therefore deductible as being outlays or expenses incurred by the partners for the purpose of producing income from the building. Under ITA s. 12(1)(a) it is immaterial that no income was in fact derived from the property. *Seigel* v. *MNR,* 7 TABC 276; 52 DTC 420 (Mr. Fisher) followed.

Aug 18/54 *Allowed*

INCOME TAX APPEAL BOARD
RULES OF PRACTICE AND PROCEDURE

P.C. 1954-1734, Nov. 18, 1954

HIS EXCELLENCY the Governor General in Council, on the recommendation of the Minister of National Revenue and pursuant to s. 87 of the Income Tax Act, is pleased to order as follows:

1. Order in Council P.C. 4302 of 24th August, 1949, as amended, whereby certain Rules of Practice and Procedure made by the Income Tax Appeal Board on August 23, 1949, were approved, is hereby revoked; and
2. The annexed "Rules of Practice and Procedure in Appeals to the Income Tax Appeal Board", made by the Board on November 12, 1954, to govern the carrying on of the business of the Board and to regulate the practice and procedure in proceedings taken before the Board, are hereby approved.

SOR/54-548 *Canada Gazette, Dec. 8/54*

RULES OF PRACTICE AND PROCEDURE
IN APPEALS TO THE INCOME TAX APPEAL BOARD

1. An appeal to the Board shall be made in writing, signed by the appellant or his solicitor or agent, and shall as closely as may be follow the form set forth in the Schedule hereto, and shall set out a statement of the allegations of fact and the reasons which the appellant intends to submit in support of the appeal.

2. The Board may request of any party to the appeal additional information relative to the assessment or the appeal therefrom and such request shall be complied with in such time as shall be directed by the Board.

3. The Board may, having regard to all the circumstances including the matter of expense and convenience to the appellant, fix the time and place for the hearing of any appeal.

4. The Board shall give to the parties to the appeal at least fifteen days notice of the time and place of the hearing.

5. The Board may postpone the hearing of any appeal and, where the postponement is not to a definite date, the Board shall give to the parties to the appeal at least fifteen days' notice of the time and place of the postponed hearing.

6. Service of any notice, request or other document provided for in these rules may be effected on any party to the appeal by personal service or by registered mail addressed in the case of the Minister to the Deputy Minister of National Revenue for Taxation at Ottawa, and in the case of the appellant to the address given in the Notice of Appeal.

7. (1) When an appeal has been set down for hearing, either party may make application to the Board for the appeal to be heard at a time or place other than appointed in the Notice of Hearing.

(2) Such application shall be made as promptly as possible after receipt of the Notice of Hearing and may be by telegram or in writing, addressed to the Registrar, Income Tax Appeal Board, Ottawa, Ontario.

(3) The application shall set out the reasons in support of the application and a copy thereof shall forthwith be sent by the applicant to the other party to the appeal.

(4) Such other party shall, as soon as possible after receipt of a copy of the application, notify the Board of his consent or opposition to the application and, if the latter, shall set out his reasons therefor.

(5) The Board may grant or refuse the application or fix such other time or place for the hearing as it deems advisable in the circumstances.

(6) Applications for postponement of a hearing, other than as under this rule provided, shall not be granted unless supported by reasons of urgency.

8. Where, pursuant to the provisions of the Act, the Board or Chairman has ordered that written submissions be filed in addition to or in place of an oral hearing, the facts set out therein shall be verified by affidavit.

Schedule

Form of Notice of Appeal:

In re the Income Tax Act and ....

(Name of Appellant)

of the .... of ....

City, Town or Village) **(Name of City, Town or Village)**

Province of ....

....

(Appellant)

Notice of Appeal to the Income Tax Appeal Board is hereby given from the assessment dated the .... day of .... 19..........
wherein a tax in the sum of $.............................. was levied in respect of income for the taxation year 19..........

Then complete the Notice of Appeal with

(1) A Statement of allegations of fact,

(2) A statement of the reasons to be advanced in support of appeal, and

(3) Address for service of notices, etc.

Dated at .... this .... day of ....19..........

....

(Signature)